ANNOTATED SECURITIES TRANSFER ACT, 2006

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Introduction

Introduction

The *Securities Transfer Act* (STA) is modeled on the *Uniform Securities Transfer Act* (USTA) that was prepared by the Canadian Securities Administrators' USTA Task Force (Task Force) and approved in 2004 by the Uniform Law Conference of Canada. In 2005, an inter-provincial group of government officials, drafters, and the Task Force worked on draft provisions with a view to maximizing uniformity among the provinces. In spring 2006, Alberta and Ontario passed almost-identical STAs, which came into effect January 1, 2007.[1]

The Ontario STA (Bill 41) included substantial complementary amendments to the Personal Property Security Act (PPSA) to ensure that the STA and the PPSA have fully harmonized provisions respecting securities and other investment property.

This Commentary on the Ontario STA has no legislative sanction, but explains and gives examples of how the STA and the related PPSA provisions should operate and is intended as an interpretive aid. The USTA included a similar Commentary, as did several previous drafts of the USTA published by the Task Force during the consultation process. This Commentary was prepared by certain members of the Task Force and two additional lawyers (John Cameron and Robert Scavone) using portions of the Official Comments to the Uniform Commercial Code (UCC) in the United States. Because most of the STA is intended to have the same substantive effect as similar provisions in Revised (1994) Article 8 of the UCC (Rev8) and Revised (1991) Article 9 of the UCC (Rev9), this Comment uses, as much as possible, the same language as the UCC Official Comments to describe substantively uniform provisions.

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[1] Since then, British Columbia, Saskatchewan and Newfoundland & Labrador have also passed STAs which closely resemble the Alberta STA. There are three notable differences between the Alberta and Ontario STAs, which are reflected in the additional provisions in sections 7, 8 and 57 of the Ontario STA. These are addressed by different Comments to those provisions and some related provisions.

This Commentary uses the following abbreviations:

- Alberta STA means *Securities Transfer Act*, S.A. 2006, c. S-4.5.
- Ontario STA means the *Securities Transfer Act, 2006*, S.O. 2006, c. 8.
- STA means the Ontario STA, or if the context requires, generally a provincial *Securities Transfer Act* that is similar to the Ontario STA or the Alberta STA.
- ABCA means Alberta *Business Corporations Act*, R.S.A. 2000, c. B-9.
- OBCA means Ontario *Business Corporations Act*, R.S.O. 1990, c. B.16.
- CBCA means *Canada Business Corporations Act*, R.S.C. 1985, c. C-44.
- BCA means generally a provincial business corporation Act that is modeled on or is similar to the CBCA
- Alberta PPSA or APPSA means Alberta *Personal Property Security Act*, R.S.A. 2000, c. P-7.
- Ontario PPSA or OPPSA means Ontario *Personal Property Security Act*, R.S.O. 1990, c. P.10.
- PPSA means the Ontario PPSA or, if the context requires, generally a provincial *Personal Property Security Act* that is similar to the OPPSA or the APPSA.
- Alberta *Civil Enforcement Act* means *Civil Enforcement Act*, R.S.A. 2000, c. C-15.
- *Bank Act* means *Bank Act*, S.C. 1991, c. 46.
- *Bankruptcy and Insolvency Act* or BIA means *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3.
- *Bills of Exchange Act* or BEA means *Bills of Exchange of Act,* R.S.C. 1985, c. B-4.
- *Cooperative Credit Associations Act* means *Cooperative Credit Associations Act*, S.C. 1991, c. 48.
- *Depository Bills and Notes Act* or DBNA means *Depository Bills and Notes Act*, S.C. 1998, c. 13.
- *Financial Administration Act* means *Financial Administration Act*, R.S.C. 1985, c. F-11.
- *Insurance Companies Act* means *Insurance Companies Act*, S.C. 1991, c. 47.
- *Securities Act* means Ontario *Securities Act*, R.S.O. 1980, c. S.5.
- *Trust and Loan Companies Act* means *Trust and Loan Companies* Act, S.C. 1991, c. 45.

- *Dickerson Report* means R. Dickerson, J. Howard and L. Getz, *Proposals for a New Business Corporations Law in Canada* (Ottawa: Minister of Supply and Services, 1971).
- UCC means the Uniform Commercial Code as amended to December 31, 2005 (except where the context otherwise requires) prepared under the joint sponsorship of The American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL).
- UCC Rev 8 or Rev8 means Revised Article 8 of the UCC as amended to December 31, 2005.
- UCC Rev 9 or Rev9 means Revised Article 9 of the UCC as amended to December 31, 2005.
- (1978) UCC 8 or "the prior version of UCC Article 8" means UCC Article 8 as it existed prior to revision in 1994.
- (1962) UCC 8 means UCC Article 8 as it existed prior to revision in 1978.
- 1909 *Uniform Stock Transfer Act* means the *Uniform Stock Transfer Act*, 6 U.L.A.
- UCC Official Comments means the Official Comments to the Uniform Commercial Code, which are copyright by The American Law Institute and the National Conference of Commissioners on Uniform State Laws.
- SRO means generally a self-regulatory organization such as the Investment Dealers Association of Canada (IDA) or the Mutual Fund Dealers Association of Canada (MFDA).
- CIPF means the Canadian Investor Protection Fund as described at http://www.cipf.ca/c_learn_bg.htm.
- CDS means The Canadian Depository for Securities Limited prior to its corporate restructuring effective November 1, 2006. Since that date, the functions formerly performed by CDS are performed by CDS Clearing and Depository Services Inc., which is now a subsidiary of The Canadian Depository for Securities Limited. More information is available at http://www.cdsltd-cdsltee.ca/cdsltdhome.nsf/Pages/-EN-Welcome?Open.
- CDCC means the Canadian Derivatives Clearing Corporation as described at http://www.cdcc.ca/accueil_en.php.

In this Commentary, a reference to "existing law", "current law" or previous law" in Canada generally means the law prior to the effective date of the STA and consequential amendments.

This Commentary notes drafting differences between certain STA provisions and comparable Rev8 and Rev9 provisions whenever a substantive difference is intended. Where no substantive difference is intended, this Commentary explains

the more important or conspicuous drafting differences but does not address many small drafting differences. These are not discussed because they are not substantive and generally reflect the adjustment to Canadian drafting style.

This Commentary refers to Canadian case law and the U.S. case law cited in the UCC Official Comments. There are relatively few Canadian cases. All the case law provides useful context for the STA because so many of its rules are essentially the codification of the law merchant, selecting the better principles from various decisions and explicitly rejecting others.

Part 1 of this Commentary was prepared by certain members of the Task Force. Part 2 of the Commentary (on the complementary PPSA amendments) was prepared by John Cameron, a partner of Torys LLP, and Robert Scavone, a partner of McMillan Binch Mendelsohn. The authors are to be commended for their achievement of a clear and helpful guide to these complex and innovative legislative provisions.

PART 1

Commentary on the *Securities Transfer Act*, 2006

Part I
Interpretation and General Provisions

Definitions

s. 1(1) In this Act,

"adverse claim" means a claim that,

(a) the claimant has a property interest in a financial asset, and

(b) it is a violation of the rights of the claimant for another person to hold, transfer or deal with the financial asset; ("opposition")

COMMENT

Source: UCC Rev 8-102(a)(1)

Comparison with previous law: See OBCA s. 53(1); ABCA s. 47(2)(a); CBCA s. 48(2); all of which are based on, and similar to, (1962) UCC 8-301(1).

Explanation: This definition is intended to be substantively uniform with the corresponding definition in Rev 8-102(a)(1).

The application of this definition and related STA provisions to security interests will be slightly different in Canada than under the UCC because Canadian PPSAs continue to include cut-off rules that are not included in Revised Article 9 of the UCC (Rev 9). See for example: PPSA s. 28(6)-(10). The PPSA cut-off rules provide an extra degree of certainty for buyers in relation to security interests, but do not affect the operation of the STA adverse claim cut-off rules.

The definition of the term "adverse claim" has two components. First, the term refers only to property interests. Second, the term means not merely that a person has a property interest in a financial asset but that it is a violation of the claimant's property interest for the other person to hold or transfer the security or other financial asset.

The term adverse claim is not, of course, limited to ownership rights, but extends to other property interests established by other law. A security interest, for example, may be an adverse claim with respect to a transferee from the debtor depending upon whether the transferee takes free of the security interest under the relevant PPSA or equivalent legislation.

The definition of adverse claim in the prior version of UCC Article 8 and previous Canadian law might have been read to suggest that any wrongful action concerning a security, even a simple breach of contract, gave rise to an adverse claim. Insofar as such cases as *Fallon v. Wall Street Clearing Corp.*, 586 N.Y.S.2d 953, 182 A.D.2d 245, (1992) and *Pentech Intl. v. Wall St. Clearing Co.*, 983 F.2d 441 (2d Cir. 1993), were based on that view, they are rejected by the new definition which explicitly limits the term adverse claim to property interests. Canadian cases have not interpreted the previous definition of "adverse claim" quite so broadly but have said, for example, that a person who claims an option to acquire a security may have an adverse claim. See *Iverson v. Westfair Foods Ltd*, [1996] 7 W.W.R. 520, appeal dismissed 1998 ABCA 337, application for leave to appeal to S.C.C. dismissed [1998] S.C.C.A. No. 634, and *Travel West (1987) Inc. v. Langdon Towers Apartment Ltd.* 2002 SKCA 51. Suppose, for example, that A contracts to sell or deliver securities to B, but fails to do so and instead sells or pledges the securities to C. B, the promisee, has an action against A for breach of contract, but absent unusual circumstances the action for breach would not give rise to a property interest in the securities. Accordingly, B does not have an adverse claim. An adverse claim might, however, be based upon principles of equitable remedies that give rise to property claims. It would, for example, cover a right established by other law to rescind a transaction in which securities were transferred. Suppose, for example, that A holds securities and is induced by B's fraud to transfer them to B. Under the law of contract or restitution, A may have a right to rescind the transfer, which gives A a property claim to the securities. If so, A has an adverse claim to the securities in B's hands. By contrast, if B had committed no fraud, but had merely committed a breach of contract in connection with the transfer from A to B, A may have only a right to damages for breach, not a right to rescind. In that case, A would not have an adverse claim to the securities in B's hands.

Definitional cross-references:	"financial asset"	s. 1(1) and s. 1(2)
	"person"	s. 1(1)
	"security interest"	s. 1(1)

"appropriate person" means,

(a) with respect to an endorsement, the person specified by a security certificate or by an effective special endorsement to be entitled to the security,

(b) with respect to an instruction, the registered owner of an uncertificated security,

(c) with respect to an entitlement order, the entitlement holder,

(d) in the case of a person referred to in clause (a), (b) or (c) being deceased, that person's successor taking under the law, other than this Act, or that person's personal representative acting for the estate of the deceased person,

(e) in the case of a person referred to in clause (a), (b) or (c) lacking capacity, that person's guardian or other similar representative who has power under the law, other than this Act, to transfer the security or other financial asset; ("personne compétente")

COMMENT

Source: UCC Rev 8-107(a)

Comparison with previous law: See OBCA s. 53(1); ABCA s. 64(1); CBCA s. 65(1); all of which are based on, and similar to, (1962) UCC 8-308(3). Previous Canadian law deals only with who is an "appropriate person" for purposes of endorsing a security certificate. The STA also addresses who is an "appropriate person" with respect to (1) an "instruction" relating to an uncertificated security, and (2) an "entitlement order" relating to a security entitlement.

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-107(a).

1. This definition, together with the definition of "effective" and sections 29 to 32, describe two concepts, "appropriate person" and "effective". Effectiveness is a broader concept than appropriate person. For example, if a security or securities account is registered in the name of Mary Roe, Mary Roe is the "appropriate person", but an endorsement, instruction, or entitlement order made by John Doe is "effective" if, under agency or other law, Mary Roe is precluded from denying Doe's authority. Treating these two concepts separately facilitates more precise wording of the STA rules that state the legal effect of an endorsement, instruction, or entitlement order. For example, a securities intermediary is protected against liability if it acts on an effective entitlement order, but has a duty to comply with an entitlement order only if it is originated by an appropriate person. See s. 54 and s. 101.

One important application of the "effectiveness" concept is in the direct holding system rules on the rights of purchasers. A purchaser of a certificated security in registered form can qualify as a protected purchaser who takes free from adverse claims under

s. 70 only if the purchaser obtains "control". Section 23(2)(a) provides that a purchaser of a certificated security in registered form obtains control if there has been an "effective endorsement".

2. The definition provides that the term "appropriate person" covers two categories: (1) the person who is actually designated as the person entitled to the security or security entitlement, and (2) the successor or legal representative of that person if that person has died or otherwise lacks capacity. Other law determines who has power to transfer a security on behalf of a person who lacks capacity. For example, if securities are registered in the name of more than one person and one of the designated persons dies, whether the survivor is the appropriate person depends on the form of tenancy. If the two were registered joint tenants with right of survivorship, the survivor would have that power under other law and thus would be the "appropriate person". If securities are registered in the name of an individual and the individual dies, the law of decedents' estates determines who has power to transfer the decedent's securities. That would ordinarily be the executor or administrator, but if the applicable statute permitted, for example, a widow to transfer a decedent's securities without administration proceedings, she would be the appropriate person. The STA does not contain a list of such representatives, because any list is likely to become outdated by developments in other law.

See also the definition of "effective" and sections 29-32 and the Comments to those provisions.

Definitional cross-references:		
	"endorsement"	s. 1(1)
	"effective"	s. 1(1)
	"entitlement order"	s. 1(1)
	"fiduciary"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"instruction"	s. 1(1)
	"representative"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)
	"security entitlement"	s. 1(1)
	"uncertificated security"	s. 1(1)

"bearer form" means, in respect of a certificated security, a form in which the security is payable to the bearer of the security certificate according to the security certificate's terms but not by reason of an endorsement; ("au porteur")

COMMENT

Source: UCC Rev 8 102(a)(2)

Comparison with previous law: See OBCA s. 53(1); ABCA s. 47(6); CBCA s. 48(6); all of which are based on, and similar to (1962) UCC 8-102(1)(d).

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(2).

The definition of "bearer form" has remained substantially unchanged since its Canadian introduction in the 1975 CBCA. The requirement that the certificate be payable to bearer by its terms rather than by an endorsement has the effect of preventing instruments governed by other law, such as chattel paper, or bills or notes subject to the *Bills of Exchange Act*, from being inadvertently swept into the STA definition of security merely by virtue of blank endorsements. Although the other elements of the definition of security in s. 1(1) probably suffice for that purpose in any event, the language used in previous law has been retained.

Definitional cross-references:

"certificated security"	s. 1(1)
"endorsement"	s. 1(1)
"security"	s. 1(1)
"security certificate"	s. 1(1)

" broker" means a dealer as defined in the *Securities Act*; ("courtier")

COMMENT

Source: UCC Rev 8-102(a)(3)

Comparison with previous law: See OBCA s. 53(1); ABCA s. 47(2)(d); CBCA s. 48(2); all of which are based on, and similar to, (1962) UCC 8-303.

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(3).

Broker is defined by reference to the definition of dealer in provincial securities laws. The definition covers both those who act as agents ("brokers" in securities parlance) and those who act as principals ("dealers" in securities parlance). Since the definition refers to persons "defined" as a dealer under provincial securities laws, rather than to persons required to "register" as a dealer under provincial securities laws, it covers not only registered dealers but also those exempt from the registration requirement. The only substantive rules that turn on the defined term "broker" are s. 40 on warranties, the provisions on intermediaries' liabilities in s. 54, and the special perfection rule in PPSA s. 19.2(2) for security interests granted by brokers.

Definitional cross-references:	"person"	s. 1(1)
	"security interest"	s. 1(1)

"certificated security" means a security that is represented by a certificate; ("valeur mobilière avec certificat")

COMMENT

Source: UCC Rev 8-102(a)(4)

Comparison with previous law: This term is not defined in the OBCA, ABCA or CBCA. The term "security certificate" is defined in OBCA s. 53(1); ABCA s. 47(2)(n); and CBCA s. 48(2).

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(4).

The term "certificated security" means a security that is represented by a security certificate. The definition of "security certificate" in s. 1(1) indicates that it does not include a certificate in electronic form.

Definitional cross-references:	"security"	s. 1(1)
	"security certificate"	s. 1(1)

"clearing agency" means a person,

(a) that carries on a business or activity as a clearing agency or clearing house within the meaning of the *Securities Act* or the securities regulatory law of another province or territory in Canada,

(b that is recognized or otherwise regulated as a clearing agency or clearing house by the Ontario Securities Commission or by a securities regulatory authority of another province or territory in Canada, and

(c) that is a securities and derivatives clearing house for the purposes of section 13.1 of the *Payment Clearing and Settlement Act* (Canada) or whose clearing and settlement system is designated under Part I of that Act; ("agence de compensation")

COMMENT

Source: UCC Rev 8-102(a)(5)

Comparison with previous law: See OBCA s. 53(1).

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(5).

The definition of clearing agency limits its application to entities that are subject to a rigorous regulatory framework. Accordingly, the definition includes only a clearing agency recognized or otherwise regulated by a provincial securities regulator that is also (i) regulated by the Bank of Canada under the federal *Payment Clearing and Settlement Act* or (ii) a "securities and derivatives clearing house" for the purposes of section 13.1 of that Act.

Definitional cross-references: "person"
s. 1(1)

"communicate" means,

(a) send a signed writing, or

(b) transmit information by any other means agreed to by the person transmitting the information and the person receiving the information,

and "communication" has a corresponding meaning; ("communiquer", "communication")

COMMENT

Source: UCC Rev 8-102(a)(6)

Comparison with previous law: This term is not defined in the OBCA, ABCA or CBCA.

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(6). Sending a signed writing always suffices as communication, but the parties can agree that a different means of transmitting information is to be used. Agreement is defined in UCC 1-201(3) to mean "the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade as provided in [UCC 1-303]". The STA does not define those terms but the same substantive result is intended in the Canadian context. Thus, use of an information transmission method might be found to be authorized by agreement, even though the parties have not explicitly so specified in a formal agreement. The term "communicate" and its variants are used in s. 1(1) (definitions of "entitlement order" and "instruction"), s. 3 (notice and knowledge) and s. 88 (demand that issuer not register transfer).

Definitional cross-references: "person" s. 1(1)

"control" has the meaning set out in sections 23 to 26; ("maîtrise")

COMMENT

Source: UCC Rev 8-102(b)

Comparison with previous law: This definition cross-references the particular descriptions of control in sections 23-26. See the comparison with previous law there.
Definitional cross-references: None.

"corporation" means any body corporate whether or not it is incorporated under the laws of Ontario; ("société")

COMMENT

Source: New.

Comparison with previous law: See the definitions of "body corporate" and "corporation" in OBCA s. 1(1); ABCA s. 1(i) and s. 1(l); CBCA s. 2(1).

Explanation: This term includes any body corporate with or without share capital, wherever or however incorporated.

Definitional cross-references: None.

"delivery", with respect to a certificated or uncertificated security, has the meaning set out in section 68, and "deliver" has a corresponding meaning; ("livraison", "livrer")

COMMENT

Source: UCC Rev 8-102(b)

Comparison with previous law: This definition cross-references the particular descriptions of delivery in s. 68. See the comparison with previous law there.

Explanation: This reflects a drafting adjustment—no substantive difference from Rev 8 is intended.

Definitional cross-references:		
	"certificated security"	s. 1(1)
	"uncertificated security"	s. 1(1)

"effective", in relation to an endorsement, instruction or entitlement order, has the meaning set out in sections 29 to 32, and "effectiveness", "ineffective" and "ineffectiveness" have corresponding meanings; ("valide", "validité", "invalide", "invalidité")

COMMENT

Source: New

Comparison with previous law: This definition cross-references the particular descriptions of effectiveness in sections 29-32. See the comparison with previous law there.

Note on French language version: The French language versions of "effective", "effectiveness", "ineffective" and "ineffectiveness" are respectively "valide", "validité", "invalide" and "invalidité". These terms have precise meanings under sections 29-32 for determining whether an endorsement, instruction or entitlement order is effective and should not be confused with the different concept in section 2 of when a security is valid (or "valide" in the French language version).

Definitional cross-references:		
	"endorsement"	s. 1(1)
	"entitlement order"	s. 1(1)
	"instruction"	s. 1(1)

"endorsement" means a signature that, alone or accompanied by other words, is made on a security certificate in registered form or on a separate document for the purpose of assigning, transferring or redeeming the security or granting a power to assign, transfer or redeem the security; ("endossement")

COMMENT

Source: UCC Rev 8-102(a)(11)

Comparison with previous law: See OBCA s. 73(1); ABCA s. 64(3); CBCA s. 65(3); all of which are based on, and similar to (1962) UCC 8-308(1).

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(11).

Endorsement is defined as a signature made on a security certificate or separate document for purposes of transferring or redeeming the security. The definition is

adapted from the language of (1962) UCC 8-308(1) and the definition of endorsement in UCC 3-204(a). The definition of endorsement does not include the requirement that the signature be made by an appropriate person or be authorized. Those questions are treated in the separate substantive provision on whether the endorsement is effective, rather than in the definition of endorsement. See sections 29-32.

Definitional cross-references:	"registered form"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)

"entitlement holder" means a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary and includes a person who acquires a security entitlement by virtue of clause 95 (1) (b) or (c); ("titulaire du droit")

COMMENT

Source: UCC Rev 8-102(a)(7)

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(7).

This term designates those who hold financial assets through intermediaries in the indirect holding system. Because many of the rules of STA Part 6 impose duties on securities intermediaries in favour of entitlement holders, the definition of entitlement holder is, in most cases, limited to the person specifically designated as such on the records of the intermediary. The last phrase of the definition covers the relatively unusual cases where a person may acquire a security entitlement under s. 95(1)(b) or (c) even though the person may not be specifically designated as an entitlement holder on the records of the securities intermediary.

A person may have an interest in a security entitlement, and may even have the right to give entitlement orders to the securities intermediary with respect to it, even though the person is not the entitlement holder. For example, a person who holds securities through

a securities account in its own name may have given discretionary trading authority to another person, such as an investment adviser. Similarly, the control provisions in sections 23-28 and the related provisions in the PPSA are designed to facilitate transactions in which a person who holds securities through a securities account uses them as collateral in an arrangement where the securities intermediary has agreed that if the secured party so directs the intermediary will dispose of the positions. In such arrangements, the debtor remains the entitlement holder but has agreed that the secured party can initiate entitlement orders.

Moreover, an entitlement holder may be acting for another person as a nominee, agent, trustee, or in another capacity. Unless the entitlement holder is itself acting as a securities intermediary for the other person, in which case the other person would be an entitlement holder with respect to the securities entitlement, the relationship between an entitlement holder and another person for whose benefit the entitlement holder holds a securities entitlement is governed by other law.

Definitional cross-references: "person" s. 1(1)
"securities intermediary" s. 1(1)
"security entitlement" s. 1(1)

"entitlement order" means a notice communicated to a securities intermediary directing the transfer or redemption of a financial asset to which the entitlement holder has a security entitlement; ("ordre relatif à un droit")

COMMENT

Source: UCC Rev 8-102(a)(8)

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(8).

This term is defined as a notice communicated to a securities intermediary directing transfer or redemption of the financial asset to which an entitlement holder has a security entitlement. The term is used in the rules for the indirect holding system in a fashion analogous to the use of the terms "endorsement" and "instruction" in the rules for the direct holding system. If a person directly holds a certificated security in

registered form and wishes to transfer it, the means of transfer is an endorsement. If a person directly holds an uncertificated security and wishes to transfer it, the means of transfer is an instruction. If a person holds a security entitlement, the means of disposition is an entitlement order. An entitlement order includes a direction under s. 102 to the securities intermediary to transfer a financial asset to the account of the entitlement holder at another financial intermediary or to cause the financial asset to be transferred to the entitlement holder in the direct holding system (e.g. the delivery of a security certificate registered in the name of the former entitlement holder). As noted in the Comment to the definition of "entitlement holder", an entitlement order need not be initiated by the entitlement holder in order to be effective, so long as the entitlement holder has authorized the other party to initiate entitlement orders. See s. 29(b).

Definitional cross-references:

"communicate"	s. 1(1)
"entitlement holder"	s. 1(1)
"financial asset"	s. 1(1) and s. 1(2)
"notice"	s. 3
"securities intermediary"	s. 1(1)
"security entitlement"	s. 1(1)

"financial asset" means, except as otherwise provided in sections 10 to 16,

(a) a security,

(b) an obligation of a person that,

(i) is, or is of a type, dealt in or traded on financial markets, or

(ii) is recognized in any other market or area in which it is issued or dealt in as a medium for investment,

(c) a share, participation or other interest in a person, or in property or an enterprise of a person, that,

(i) is, or is of a type, dealt in or traded on financial markets, or

(ii) is recognized in any other market or area in which it is issued or dealt in as a medium for investment,

(d) any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has

expressly agreed with the other person that the property is to be treated as a financial asset under this Act, or

(e) a credit balance in a securities account, unless the securities intermediary has expressly agreed with the person for whom the account is maintained that the credit balance is not to be treated as a financial asset under this Act; ("actif financier")

COMMENT

Source: UCC Rev 8-102(a)(9)

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(9).

The definition of "financial asset", in conjunction with the definition of "securities account" in s. 1(1), sets the scope of the indirect holding system rules of Part 6 of the STA. The Part 6 rules apply not only to securities held through intermediaries, but also to other financial assets held through intermediaries. The term financial asset is defined to include not only securities but also a broader category of obligations, shares, participations, and interests.

Having separate definitions of security and financial asset makes it possible to separate the question of the proper scope of the traditional direct transfer rules from the question of the proper scope of the new indirect holding system rules. Some forms of financial assets should be covered by the indirect holding system rules of Part 6, but not by the rules of Parts 3, 4, and 5. The term financial asset is used to cover such property. Because the term security entitlement is defined in terms of financial assets rather than securities, the rules concerning security entitlements set out in Part 6 of the STA and in the consequential amendments to PPSAs apply to the broader class of financial assets.

The fact that something does or could fall within the definition of financial asset does not, without more, trigger STA coverage. The indirect holding system rules of the STA apply only if the financial asset is in fact held in a securities account, so that the interest of the person who holds the financial asset through the securities account is a security entitlement. Thus, questions of the scope of the indirect holding system rules cannot be framed as "Is such-and-such a 'financial asset' under the STA?" Rather, one must

analyze whether the relationship between an institution and a person on whose behalf the institution holds an asset falls within the scope of the term securities account as defined in s. 1(1). That question turns in large measure on whether it makes sense to apply the Part 6 rules to the relationship.

The STA definition includes a clause dealing specifically with a credit balance in a securities account, which is not found in the Rev 8 definition. There are some differences between the U.S. and Canadian regulatory requirements governing the handling of free credit balances by intermediaries. In practice, credit balances in a securities account are often held in the form of units or shares in a money market mutual fund or a similar financial asset. Now that the STA is in force, it may be expected that control agreements and account agreements will normally specify that all property credited to the account will be treated as a financial asset. In order to provide clarity and certainty from the outset, the STA definition provides that a credit balance in a securities account is a financial asset. This accords with the general practice and expectations of the parties, but they are free to agree otherwise if they wish.

See also s. 1(2), which describes the contextual meaning of "financial asset".

Definitional cross-references:

"person"	s. 1(1)
"securities account"	s. 1(1)
"securities intermediary"	s. 1(1)
"security"	s. 1(1)

"genuine" means free of forgery or counterfeiting; ("authentique")

COMMENT

Source: UCC 1-201(b)(19)

Comparison with previous law: See OBCA s. 53(1); ABCA s. 47(2)(h); CBCA s. 48(2); all of which are based on, and similar to, the UCC Article 1 definition.

Explanation: This definition is unchanged.

Definitional cross-references: None.

"government" means,

(a) the Crown in right of Canada or in right of Ontario or another province of Canada,

(b) the government of a territory in Canada,

(c) a municipality in Canada, or

(d) the government of a foreign country or of any political subdivision of it; ("gouvernement")

COMMENT

Source: New

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with transfers of securities.

Explanation: This term is used in s. 8(3) and s. 57(2) and (3), which deal with the enforcement of securities issued by a government, and in the definition of "person" in s. 1(1).

Definitional cross-references: None.

"in collusion" means in concert, by conspiratorial arrangement or by agreement for the purpose of violating a person's rights in respect of a financial asset; ("collusion")

COMMENT

Source: New.

Comparison with previous law: There is no comparable provision in previous law.

Explanation: This definition is intended to produce substantive uniformity between STA provisions and Rev 8 provisions that use the term "collusion". These are s. 54(3), s. 91(1)(b)(iv) and s. 97(7)(c) of the STA and UCC Rev 8-115(2), 8-404(a)(4) and 8-

503(e). UCC Rev 8 does not define "collusion" although it is discussed in the UCC Official Comments, particularly the Official Comment to Rev 8-115. The STA definition is intended to address any possible uncertainty that might arise from the statement of "Legislative Intent" by the New York Legislature that accompanied the enactment of Revised Article 8 in L. 1997, c. 566, s. 1. That statement discusses the intended meaning of "collusion", referring to "...actual knowledge that the securities intermediary has violated or is violating an entitlement holder's property interest..." and "...actual knowledge of an intermediary's wrongdoing". It was suggested (see H. Darmstader, "Three Article 8 Cases" 2002, 57 Bus. Law. 1741 at 1747-50) that the New York statement could be interpreted to suggest that mere knowledge constitutes collusion. Since the statement of Legislative Intent is not completely clear on this important point, the STA definition is intended to make clear that mere knowledge is not necessarily collusion; that collusion requires active participation in the wrongdoing of the transferor; and that knowledge that the transfer is wrongful is a necessary but not necessarily conclusive condition of the collusion test. This definition is intended to be consistent with the statement of Legislative Intent and with the UCC Official Comments regarding collusion.

Definitional cross-references:	"financial asset"	s. 1(1) and s. 1(2)
	"person"	s. 1(1)

"instruction" means a notice communicated to the issuer of an uncertificated security that directs that the transfer of the security be registered or that the security be redeemed; ("instructions")

COMMENT

Source: UCC Rev 8-102(a)(12)

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the transfer of uncertificated securities.

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(12).

The term "instruction" is defined as a notice communicated to the issuer of an uncertificated security directing that transfer be registered or that the security be redeemed. Instructions are the analog for uncertificated securities of endorsements of certificated securities. Sections 29-32 specify who may initiate an effective instruction.

Definitional cross-references:	"communicate"	s. 1(1)
	"issuer"	s. 1(1)
	"notice"	s. 3
	"security"	s. 1(1)
	"uncertificated security"	s. 1(1)

"issuer"(a) with respect to a registration of a transfer of a security, means a person on whose behalf transfer books are maintained,

(b) with respect to an obligation on or a defence to a security, includes,

(i) a person who places or authorizes the placing of the person's name on a security certificate, other than as authenticating trustee, registrar, transfer agent or the like, to evidence,

(A) a share, participation or other interest in the person's property or in an enterprise, or

(B) the person's duty to perform an obligation represented by the security certificate,

(ii) a person who creates a share, participation or other interest in the person's property or in an enterprise, or undertakes an obligation, that is an uncertificated security,

(iii) a person who directly or indirectly creates a fractional interest in the person's rights or property, if the fractional interest is represented by a security certificate,

(iv) a guarantor, to the extent of the guarantor's guarantee, whether or not the guarantor's obligation is noted on a security certificate, and

(v) a person that becomes responsible for, or in place of, another person described as an issuer in this definition; ("émetteur")

COMMENT

Source: UCC Rev 8-201

Comparison with previous law: See OBCA s. 53(1); ABCA s. 47(2)(k); CBCA s. 48(2); all of which are based on, and similar to, (1962) UCC 8-201(1). See OBCA s. 62(1); ABCA s. 47(7); CBCA s. 48(7); all of which are based on, and similar to, (1962) UCC 8-201(2). See also OBCA s. 62(2), which is based on, and similar to, (1962) UCC 8-201(3). There is no provision comparable to OBCA s. 62(2) in the ABCA or CBCA.

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-201.

The definition of "issuer" in this section functions primarily to describe the persons whose defenses may be cut off under the rules in Part 3. In large measure it simply tracks the language of the definition of security in s. 1(1).

The first paragraph narrows the definition of "issuer" for purposes of STA Part 5 (registration of transfer). It is supplemented by s. 94.

The definition distinguishes the obligations of a guarantor as issuer from those of the principal obligor. However, it does not exempt the guarantor from the impact of s. 59. Whether or not the obligation of the guarantor is noted on the security is immaterial. Typically, guarantors are parent corporations, or stand in some similar relationship to the principal obligor. If that relationship existed at the time the security was originally issued the guarantee would probably have been noted on the security. However, if the relationship arose afterward, e.g., through a purchase of stock or properties, or through merger or consolidation, probably the notation would not have been made. Nonetheless, the holder of the security is entitled to the benefit of the obligation of the guarantor.

Definitional cross-references:		
	"person"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)
	"uncertificated security"	s. 1(1)

"knowledge" means actual knowledge, and "know" and "known" have corresponding meanings; ("connaissance", "connaître", "connu")

COMMENT

Source: UCC 1-202(b)

Comparison with previous law: There is no comparable provision in existing Canadian law relating to the transfer of securities. See PPSA s. 69.

Explanation: This definition is intended to be substantively uniform with the corresponding provision of UCC 1-202(b). See s. 3, which describes knowledge as one of the means by which a person may have "notice" of a fact. This term is also used in sections 18, 19, 33, 38 and 62.

"overissue" means the issue of securities in excess of the amount that the issuer is authorized to issue; ("émission excédentaire")

COMMENT

Source: UCC Rev 8-210(a)

Comparison with previous law: See OBCA s. 53(1); ABCA s. 47(2)(l); CBCA s. 48(2); all of which are based on, and similar to, (1962) UCC 8-104(2).

Explanation: This definition is intended to be broader than the corresponding definitional provisions of Rev 8-210(a).

Deeply embedded in corporation law is the conception that "corporate power" to issue securities stems from the statute, either general or special, under which the corporation is organized. Historically, certain Canadian corporation statutes required that the charter or articles of incorporation state, at least as to capital shares, maximum limits in terms of number of shares or total dollar capital. Some special incorporation statutes are similarly drawn and sometimes similarly limit the face amount of authorized debt securities. The theory is that issue of securities in excess of the authorized amounts is prohibited. See for example, *McWilliams v. Geddes & Moss Undertaking Co.*, 169 So. 894 (1936, La.); *Crawford v. Twin City Oil Co.*, 216 Ala. 216, 113 So. 61 (1927); *New York and New Haven R.R. Co. v. Schuyler*, 34 N.Y. 30 (1865). This conception persists despite modern corporation statutes that allow for an authorized unlimited number of shares to be

issued. Articles of incorporation generally permit the issuance of additional shares without much difficulty.

The overissue provisions (see s. 67) rarely apply. We are not aware that the overissue provisions in existing Canadian law have ever been judicially considered. The purpose of these provisions is merely to provide clarity and certainty if such rare events do arise. One potential application of the overissue provisions is the situation contemplated by existing OBCA s. 56(8) and (10), where an issuer is obligated, but fails, to disclose a transfer restriction. In that situation, the transfer restriction is not enforceable against an innocent purchaser without notice (see s. 62 and s. 86) but, if the issuer is not authorized to register the transfer because it would result in the violation of some constraint, s. 67 provides the appropriate solution. The STA definition is broader than the Rev 8 definition in that it is not limited to corporations. Since it is possible that overissue could arise in a non-corporate context (i.e. with trust or partnership units), the STA definition is expanded to provide clarity and certainty in that broader context.

Definitional cross-references: "issuer" s. 1(1)
"security" s. 1(1)

"person" means an individual, including an individual in his or her capacity as trustee, executor, administrator or other representative, a sole proprietorship, a partnership, an unincorporated association, an unincorporated syndicate, an unincorporated organization, a trust, including a business trust, a corporation, a government or agency of a government or any other legal or commercial entity; ("personne")

COMMENT

Source: OBCA s. 1(1)

Comparison with previous law: See OBCA s. 1(1); ABCA s. 1(x); CBCA s. 2(1); UCC 1-201(b)(27).

Explanation: This inclusive definition is expanded from current OBCA s. 1(1). It is intended to be all-inclusive. The Crown is included through the reference to a "government". See s. 8 dealing with the application of the STA to the Crown.

Definitional cross-references: "corporation" s. 1(1)

	"government"	s. 1(1)
	"representative"	s. 1(1)

"protected purchaser" means a purchaser of a certificated or uncertificated security, or of an interest in the security, who,

(a) gives value,

(b) does not have notice of any adverse claim to the security, and

(c) obtains control of the security; ("acquéreur protégé")

COMMENT

Source: UCC Rev 8-303(a)

Comparison with previous law: See definition of "good faith purchaser" in OBCA s. 53(1); definitions of "bona fide purchaser" in ABCA s. 47(2)(c) and CBCA s. 48(2); all of which are based on, and similar to, the definition of "bona fide purchaser" in (1962) UCC 8-302.

Explanation: This definition is intended to be substantively uniform with the corresponding provision of Rev 8-303(a).

This definition lists the requirements that a purchaser must meet to qualify as a "protected purchaser". Section 70 provides that a protected purchaser takes its interest free from adverse claims. "Purchaser" is defined broadly in s. 1(1). A secured party as well as an outright buyer can qualify as a protected purchaser. Also, "purchase" includes taking by issue, so a person to whom a security is originally issued can qualify as a protected purchaser.

To qualify as a protected purchaser, a purchaser must give value, take without notice of any adverse claim, and obtain control. Value is used in the broad sense defined in s. 1(1). See also s. 55 (securities intermediary as purchaser for value). Adverse claim is defined in s. 1(1). Sections 18-22 specify whether a purchaser has notice of an adverse claim. Control is defined in sections 23-26. To qualify as a protected purchaser there must be a time at which all of the requirements are satisfied. Thus if a purchaser obtains notice of an adverse claim before giving value or satisfying the requirements for control, the purchaser cannot be a protected purchaser. See also s. 74.

The requirement that a protected purchaser obtain control expresses the point that to qualify for the adverse claim cut-off rule a purchaser must take through a transaction that is implemented by the appropriate mechanism. By contrast, the rules in Part 3 provide that any purchaser for value of a security without notice of a defence may take free of the issuer's defence based on that defence. See sections 56-59.

The requirements for control differ depending on the form of the security. For securities represented by bearer certificates, a purchaser obtains control by delivery. See s. 23(1) and s. 68(1). For securities represented by certificates in registered form, the requirements for control are: (1) delivery as defined in s. 68(1), plus (2) either an effective endorsement or registration of transfer by the issuer. See s. 23(2). Thus, a person who takes through a forged endorsement does not qualify as a protected purchaser by virtue of the delivery alone. If, however, the purchaser presents the certificate to the issuer for registration of transfer, and the issuer registers transfer over the forged endorsement, the purchaser can qualify as a protected purchaser of the new certificate. If the issuer registers transfer on a forged endorsement, the true owner will be able to recover from the issuer for wrongful registration, see s. 91, unless the owner's delay in notifying the issuer of a loss or theft of the certificate results in preclusion under s. 93. If the issuer is the Crown, these provisions may not apply: see s. 8.

For uncertificated securities, a purchaser can obtain control either by delivery, see s. 24(1)(a) and s. 68(2), or by obtaining an agreement pursuant to which the issuer agrees to act on instructions from the purchaser without further consent from the registered owner, see s. 24(1)(b). A secured lender who obtains a control agreement under s. 24(1)(b) can qualify as a protected purchaser of an uncertificated security.

Section 70 states directly the rules determining whether one takes free from adverse claims without using the phrase "good faith". Whether a person who takes under suspicious circumstances is disqualified is determined by sections 18-22 on notice of adverse claims. The term "protected purchaser", which replaces the term "bona fide purchaser" used in the prior version of UCC Article 8 and some existing Canadian legislation, is derived from the term "protected holder" used in the Convention on International Bills and Notes prepared by the United Nations Commission on International Trade Law ('UNCITRAL').

Definitional cross-references:		
	"adverse claim"	s. 1(1)
	"certificated security"	s. 1(1)
	"control"	s. 1(1)
	"notice of an adverse claim"	sections 18-22
	"purchaser"	s. 1(1)

	"secured party"	s. 1(1)
	"uncertificated security"	s. 1(1)
	"value"	s. 1(1) and s. 55

"purchase" means a taking by sale, discount, negotiation, mortgage, hypothec, pledge, security interest, issue or reissue, gift or any other voluntary transaction that creates an interest in property; ("acquisition", "acquérir")

COMMENT

Source: UCC 1-201(b)(29)

Comparison with previous law: See the definitions of "purchaser" in OBCA s. 53(1); ABCA s. 47(2)(m); CBCA s. 48(2); all of which are based on, and similar to the definition of "purchase" in (1962) UCC 1-201.

Explanation: This definition is intended to be substantively similar to the corresponding definition in UCC 1-201(b)(29). Together with the definition of "purchaser", it essentially uses modernized uniform language to re-state existing law. It tracks the UCC where it adds taking by "discount" and "security interest" to existing Canadian definitions. It maintains the existing slight differences between the Canadian and U.S. law where it includes taking by "hypothec" and excludes taking by "lien".

Definitional cross-references: "security interest" s. 1(1)

"purchaser" means a person who takes by purchase; ("acquéreur")

COMMENT

Source: UCC 1-201(b)(30)

Comparison with previous law: See the definitions of "purchaser" in OBCA s. 53(1); ABCA s. 47(2)(m); CBCA s. 48(2); all of which are based on, and similar to the definition of "purchase" in (1962) UCC 1-201.

Explanation: This definition is intended to be substantively similar to the corresponding definition in UCC 1-201(b)(30). Together with the definition of "purchase", it essentially uses modernized uniform language to re-state existing law.

Definitional cross-references: "person" s. 1(1)

"registered form" means, in respect of a certificated security, a form in which,

(a) the security certificate specifies a person entitled to the security,

and

(b) a transfer of the security may be registered on books maintained for that purpose by or on behalf of the issuer, or the security certificate states that it may be so registered; ("nominatif")

COMMENT

Source: UCC Rev 8-102(a)(13)

Comparison with previous law: See OBCA s. 53(1); ABCA s. 47(4); CBCA s. 48(4); all of which are based on, and similar to, (1962) UCC 8-102(1)(c).

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102 (a)(13).

The definition of "registered form" is substantially the same as in previous law. Like the definition of bearer form, it serves primarily to distinguish STA securities from instruments governed by other law, such as the *Bills of Exchange Act*.

Definitional cross-references:

"certificated security"	s. 1(1)
"issuer"	s. 1(1)
"person"	s. 1(1)
"security"	s. 1(1)
"security certificate"	s. 1(1)

"representative" means any person empowered to act for another, including an agent, an officer of a corporation or association and a trustee, executor or administrator of an estate; ("représentant")

COMMENT

Source: UCC 1-201(b)(33)

Comparison with previous law: OBCA s. 1(1) and CBCA 2(1) define "personal representative". This term is used in CBCA s. 51(2) and (8), but in the corresponding provisions in OBCA s. 67(2) and (8), the undefined term "legal representative" is used. The ABCA does not define any of these terms, although the term "legal representative" is used in ABCA s. 50(2) and (8). There have never been equivalent provisions in UCC Article 8.

Explanation: This definition is intended to be substantively uniform with the corresponding definition in UCC 1-201(b)(33), which was introduced in 1994. This term is used in the STA definitions of "appropriate person", "fiduciary" and "person", and in s. 19(1), s. 19(2), s. 30 and s. 31.

Definitional cross-references:		
	"corporation"	s. 1(1)
	"person"	s. 1(1)

"secured party" means a secured party as defined in the *Personal Property Security Act*; ("créancier garanti")

COMMENT

Source: New.

Comparison with previous law: New.

Explanation: This definition cross-references the definition in the PPSA. The term "secured party" is used in sections 39 and 49. It complements the STA definition of "security interest", which also cross-references the definition in the PPSA.

Definitional cross-references:		
	"security interest"	s. 1(1)

"securities account" means an account to which a financial asset is or may be credited in accordance with an agreement under which

the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that constitute the financial asset; ("compte de titres")

COMMENT

Source: UCC Rev 8-501(a)

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This definition is intended to be substantively uniform with the corresponding definition in Rev 8-501(a).

The rules of STA Part 6 apply to security entitlements, and s. 95(1) provides that a person has a security entitlement when a financial asset has been credited to a "securities account". Thus, the term "securities account" specifies the type of arrangements between institutions and their customers that are covered by Part 6. A securities account is a consensual arrangement in which the intermediary undertakes to treat the customer as entitled to exercise the rights that comprise the financial asset. The consensual aspect is covered by the requirement that the account be established pursuant to agreement. Agreement is defined in UCC 1-201(b)(3) to mean "the bargain of the parties in fact as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade…", and a similarly broad meaning is intended here in the Canadian context. There is no requirement that a formal or written agreement be signed.

As the securities business is presently conducted, several significant relationships clearly fall within the definition of a securities account, including the relationship between a clearing agency and its participants, a broker and customers who leave securities with the broker, and a bank or trust company acting as securities custodian and its custodial customers. Given the enormous variety of arrangements concerning securities that exist today, and the certainty that new arrangements will evolve in the future, it is not possible to specify all of the arrangements to which the term does and does not apply.

Whether an arrangement between a firm and another person concerning a security or other financial asset is a "securities account" under the STA depends on whether the firm has undertaken to treat the other person as entitled to exercise the rights that comprise the security or other financial asset. Basic principles of Canadian statutory

interpretation dictate that the STA provisions should be construed and applied to promote their underlying purposes and policies. Thus, the question whether a given arrangement is a securities account should be decided not by dictionary analysis of the words of the definition taken out of context, but by considering whether it promotes the objectives of the STA to include the arrangement within the term securities account.

The effect of concluding that an arrangement is a securities account is that the rules of Part 6 apply. Accordingly, the definition of "securities account" must be interpreted in light of the substantive provisions in Part 6, which describe the core features of the type of relationship for which the commercial law rules of the STA concerning security entitlements were designed. There are many arrangements between institutions and other persons concerning securities or other financial assets which do not fall within the definition of "securities account" because the institutions have not undertaken to treat the other persons as entitled to exercise the ordinary rights of an entitlement holder specified in the Part 6 rules. For example, the term securities account does not cover the relationship between a bank and its depositors or the relationship between a trustee and the beneficiary of an ordinary trust, because those are not relationships in which the holder of a financial asset has undertaken to treat the other as entitled to exercise the rights that comprise the financial asset in the fashion contemplated by the Part 6 rules.

In short, the primary factor in deciding whether an arrangement is a securities account is whether application of the Part 6 rules is consistent with the expectations of the parties to the relationship. Relationships not governed by Part 6 may be governed by other parts of the STA if the relationship gives rise to a new security, or may be governed by other law entirely.

Definitional cross-references:	"financial asset"	s. 1(1) and s. 1(2)
	"person"	s. 1(1)

"securities intermediary" means,

(a) a clearing agency, or

(b) a person, including a broker, bank or trust company, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity; ("intermédiaire en valeurs mobilières")

COMMENT

Source: UCC Rev 8-102(a)(14)

Comparison with previous law: There is no comparable definition in existing Canadian law dealing with the indirect holding system.

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(14).

A "securities intermediary" is a person that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity. The most common examples of securities intermediaries would be clearing agencies holding securities for their participants, banks or trust companies acting as securities custodians, and brokers holding securities on behalf of their customers. For greater certainty, clearing agencies are listed separately as a category of securities intermediary even though, in most circumstances, they would fall within the general definition. Clearing agencies such as The Canadian Depository for Securities Limited (CDS) also perform the trade comparison, clearance, and netting function in securities settlement, in addition to acting as the depository. The definition is intended to make clear that, because CDS is a clearing agency, it is a securities intermediary under the STA regardless of whether it is at any particular time or in any particular aspect of its operations holding securities on behalf of its participants.

The terms securities intermediary and broker have different meanings. Broker means a person engaged in the business of buying and selling securities, as agent for others or as principal. Securities intermediary means a person maintaining securities accounts for others. A stockbroker, in the colloquial sense, may or may not be acting as a securities intermediary.

The general definition of securities intermediary includes the requirement that the person in question is acting in the capacity of maintaining securities accounts for others. This is to take account of the fact that a particular entity, such as a bank or trust company, may act in many different capacities in securities transactions. A bank or trust company may act as a transfer agent for issuers, as a securities custodian for institutional investors and private investors, as a dealer in government securities, as a lender taking securities as collateral, and as a provider of general payment and collection services that might be used in connection with securities transactions. A bank or trust company that maintains securities accounts for its customers would be a securities intermediary with respect to

those accounts; but if it takes a pledge of securities from a borrower to secure a loan, it is not thereby acting as a securities intermediary with respect to the pledged securities, since it holds them for its own account rather than for a customer. In other circumstances, those two functions might be combined. For example, the bank or trust company may maintain securities accounts for customers and also provide the customers with margin credit to purchase or carry the securities, in much the same way that brokers provide margin loans to their customers.

Definitional cross-references:	"broker"	s. 1(1)
	"clearing agency"	s. 1(1)
	"person"	s. 1(1)
	"securities account"	s. 1(1)

"security" means, except as otherwise provided in sections 10 to 16, an obligation of an issuer or a share, participation or other interest in an issuer or in property or an enterprise of an issuer,

(a) that is represented by a security certificate in bearer form or registered form, or the transfer of which may be registered on books maintained for that purpose by or on behalf of the issuer,

(b) that is one of a class or series, or by its terms is divisible into a class or series, of shares, participations, interests or obligations, and

(c) that,

(i) is, or is of a type, dealt in or traded on securities exchanges or securities markets, or

(ii) is a medium for investment and by its terms expressly provides that it is a security for the purposes of this Act; ("valeur mobilière")

COMMENT

Source: UCC Rev 8-102(a)(15)

Comparison with previous law: See OBCA s. 53(1); ABCA s. 47(2)(n); CBCA s. 48(2). The ABCA and CBCA definitions are based on, and similar to, (1962) 8-102(1)(a) which contemplate that a security must be an "instrument". The OBCA definition contemplates uncertificated securities but is not uniform with any version of the UCC definition. Many

existing Canadian definitions include securities in order form. That aspect of the definition was introduced in the 1975 CBCA on the basis of a recommendation in the 1971 *Dickerson Report*. It is not included in the STA definition because we are unaware that there have ever been order form instruments that otherwise meet the definition of "'security".

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(15).

The definition of "security" has three components. First, there is the test that the interest or obligation be fully transferable, in the sense that the issuer either maintains transfer books or the obligation or interest is represented by a certificate in bearer or registered form. Second, there is the test that the interest or obligation be divisible, that is, one of a class or series, as distinguished from individual obligations of the sort governed by ordinary contract law or by the *Bills of Exchange Act*. Third, there is the functional test, which generally turns on whether the interest or obligation is, or is of a type, dealt in or traded on securities markets or securities exchanges. There is, however, an "opt-in" provision which permits the issuer of any interest or obligation that is "a medium of investment" to specify that it is a security for the purposes of the STA.

The divisibility test applies to the security—that is, the underlying intangible interest—not the means by which that interest is evidenced. Thus, securities issued in book-entry only form meet the divisibility test because the underlying intangible interest is divisible via the mechanism of the indirect holding system. This is so even though the clearing agency is the only eligible direct holder of the security.

The third component, the functional test, provides flexibility while ensuring that the STA rules do not apply to interests or obligations in circumstances so unconnected with the securities markets that parties are unlikely to have thought of the possibility that the STA might apply. This component covers interests or obligations that either are dealt in or traded on securities exchanges or securities markets, or are of a type dealt in or traded on securities exchanges or securities markets. The "is dealt in or traded on" phrase eliminates problems in the characterization of new forms of securities which are to be traded in the markets, even though no similar type has previously been dealt in or traded in the markets. This component also covers the broader category of media for investment, but it applies only if the terms of the interest or obligation specify that it is a security for the purposes of the STA. This opt-in provision allows for deliberate expansion of the scope of the STA.

Sections 10-16 contain additional rules on the treatment of particular interests as

securities or financial assets.

Definitional cross-references:		
	"bearer form"	s. 1(1)
	"issuer"	s. 1(1)
	"registered form"	s. 1(1)
	"security certificate"	s. 1(1)

"security certificate" means a certificate representing a security, but does not include a certificate in electronic form; ("certificat de valeur mobilière")

COMMENT

Source: UCC Rev 8-102(a)(16)

Comparison with previous law: See OBCA s. 53(1); ABCA s. 47(2)(n); CBCA s. 48(2).

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(16).

The term "security" refers to the underlying asset, e.g., 1000 shares of common stock of Acme, Inc. The term "security certificate" refers to the paper certificates that have traditionally been used to embody the underlying intangible interest. The definition specifies that a security certificate is a physical certificate only by excluding any form of electronic media.

Definitional cross-references:		
	"security"	s. 1(1)

"security entitlement" means the rights and property interest of an entitlement holder with respect to a financial asset that are specified in Part VI; ("droit intermédié")

COMMENT

Source: UCC Rev 8-102(a)(17)

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(17).

"Security entitlement" means the rights and property interest of a person who holds securities or other financial assets through a securities intermediary. A security entitlement is both a package of personal rights against the securities intermediary and an interest in the property held by the securities intermediary. A security entitlement is not, however, a specific property interest in any financial asset held by the securities intermediary or by the clearing agency through which the securities intermediary holds the financial asset. See s. 17(3) and s. 97. The formal definition of security entitlement in s. 1(1) is a cross-reference to the rules of Part 6. In a sense, then, the entirety of Part 6 is the definition of security entitlement. The Part 6 rules specify the rights and property interest that comprise a security entitlement.

Definitional cross-references:	"entitlement holder"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)

"security interest" means a security interest as defined in the *Personal Property Security Act*; ("sûreté")

COMMENT

Source: New.

Comparison with previous law: New.

Explanation: This definition cross-references the definition in the PPSA. The term "security interest" is important because it has been added to the Rev 8 and STA definitions of "purchase", which formerly referred only to a "pledge". Although security interests may have been captured by the term "pledge" or otherwise in the previous definition, this definition removes any uncertainty.

Definitional cross-references: None.

"unauthorized" means, when used with reference to a signature or endorsement, a signature or endorsement that is made without actual, implied or apparent authority or that is forged; ("non autorisé")

COMMENT

Source: CBCA s. 48(2)

Comparison with previous law: See OBCA s. 53(1); ABCA s. 44(2)(q); CBCA s. 48(2); all of which are based on, and similar to (1962) UCC 1-201(43).

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of UCC 1-201(b)(41). In contrast with (1962) UCC 1-201(43), the current version of UCC 1-201(b)(41) no longer refers to an endorsement, only to an 'unauthorized signature'. That change to the Article 1 definition was intended to resolve ambiguity about its application to UCC Articles 3 and 4. No such ambiguity arises in the context of the STA so it preserves the reference to an endorsement.

Definitional cross-references: "endorsement" s. 1(1)

"uncertificated security" means a security that is not represented by a certificate; ("valeur mobilière sans certificat")

COMMENT

Source: UCC Rev 8-102(a)(18)

Comparison with previous law: See OBCA s. 53(1). There is no comparable provision in the ABCA or CBCA.

Explanation: This definition is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(18).

The term "uncertificated security" means a security that is not represented by a security certificate. For uncertificated securities, there is no need to draw any distinction between the underlying asset and the means by which a direct holder's interest in that asset is

evidenced. Compare "certificated security" and "security certificate".

Definitional cross-references: "security" s. 1(1)

"value" means any consideration sufficient to support a simple contract and includes an antecedent debt or liability. ("contrepartie")

COMMENT

Source: Saskatchewan PPSA s. 2(1)(tt)

Comparison with previous law: There is no definition of "value" in existing Canadian legislation relating to securities transfers. There are minor variations in the definitions in PPSAs, all of which are based on the Model Uniform PPSA. The Saskatchewan version was chosen as representative; see also OPPSA s. 1(1) and APPSA s. 1(1)(ww).

Explanation: This definition tracks the wording of existing PPSAs. It is intended to be substantively uniform with the corresponding definition of value in UCC 1-204, which uses different language but appears to mean the same thing.

Definitional cross-references: None.

Interpretation – financial asset

(2) As the context requires, "financial asset" means either the interest itself or the means by which a person's claim to it is evidenced, including a certificated or uncertificated security, a security certificate and a security entitlement.

COMMENT

Source: UCC Rev 8-102(a)(9)

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: The definition of "financial asset" in the STA is intended to be substantively uniform with the corresponding provisions of Rev 8-102(a)(9). The separation of this provision from the balance of the definition of "financial asset" in s. 1(1) in the STA reflects a different drafting approach only.

This provision provides that the term financial asset refers both to the underlying asset and the particular means by which ownership of that asset is evidenced. Thus, with respect to a certificated security, the term financial asset may, as context requires, refer either to the interest or obligation of the issuer or to the security certificate representing that interest or obligation. Similarly, if a person holds a security or other financial asset through a securities account, the term financial asset may, as context requires, refer either to the underlying asset or to the person's security entitlement.

Definitional cross-references:		
	"certificated security"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"person"	s. 1(1)
	"security certificate"	s. 1(1)
	"security entitlement"	s. 1(1)
	"uncertificated security"	s. 1(1)

Interpretation limited to this Act

(3) The characterization of a person, business or transaction for the purposes of this Act does not determine the characterization of the person, business or transaction for the purposes of any other statute, law, regulation or rule.

COMMENT

Source: UCC Rev 8-102(d)

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the transfer of securities.

Explanation: This provision makes clear what would otherwise be implicit. The STA uses formal, precise characterizations for a specific purpose—to provide clear and certain property-transfer rules. Other statutes, law, regulations and rules generally need not use such characterizations for their purposes.

For example, the definition of "security" in the *Securities Act* is crafted to ensure that it captures any interest or investment that should trigger the protective requirements of that *Act*, which may include things (e.g. interests in land) that are clearly outside the scope of the STA definition. Conversely, the STA characterization of a transaction should not determine the characterization of that transaction for purposes of the *Securities Act*. The STA is not intended to affect regulatory compliance requirements or to require changes to existing securities account documents or other agreements. See s. 17(4).

Similarly the STA is not intended to change, or necessarily determine, accounting or tax treatment of property. As s. 17 indicates, for commercial law-purposes a security entitlement is one way of acquiring an interest in a security that is normally equivalent to delivery and possession of a security certificate. This merely codifies the expected property-law consequences of existing commercial practice, which for most purposes treats a person as the "owner" of securities notwithstanding that the securities are within the indirect holding system.

Definitional cross-references: "person" s. 1(1)

Meaning of valid security

2. A security is valid if it is issued in accordance with the applicable law described in subsection 44 (1) and the constating provisions governing the issuer.

COMMENT

Source: New

Comparison with previous law: See the definitions of "valid" in OBCA s. 53(1); ABCA s. 47(2)(r); CBCA s. 48(2). There is no comparable provision in the UCC. A definition of "valid" was added at some point during the development of the original CBCA but is not mentioned in the 1971 *Dickerson Report*.

Explanation: This definition applies to s. 44(1), s. 56(2), and s. 57(3).

The STA definition of "valid" is different from the definitions in existing Canadian law. The existing definitions reflect what is implicit in Rev 8—that defences going to the "validity" of a security are a particular subset of the larger universe of defences that may arise. See J. Halpern, "Defining the 'Validity' of a 'Security' Under Article 8" 12 UCC L.J. 195

(1980). The concept of validity in Rev 8 and existing Canadian law does not distinguish between, for example: 1) whether securities are properly-issued under the applicable corporate law; and 2) whether securities that are not properly-issued under the applicable corporate law are still enforceable because the issuer is estopped from denying their validity. Under Rev 8, both those questions fall under state law but, in Canada, question #1 may fall under Canadian federal law (e.g. the CBCA or the *Bank Act*) while question #2 is a matter of provincial law (property and civil rights in the province). The STA distinguishes between "validity" and enforceability/estoppel, defining "valid" more narrowly so that it refers only to question #1. The distinction enables the STA choice of law rules to address precisely which jurisdiction's law governs question #1 (see s. 44(1)), and which jurisdiction's law governs question #2 (see s. 44(4)). See s. 44 and Comment.

The UCC recognizes the distinction between validity and estoppel but deliberately "validates" invalid securities in the hands of innocent purchasers instead of allowing damages against the issuer, in order to avoid giving preference to such a purchaser over other investors (see 1958 Official Comment to 8-202). That response addressed situations in the late 19th century where U.S. municipalities invalidly issued securities to finance railroad construction and later refused or were unable to pay. Sections 57 to 59 are generally based on the UCC codification of the better case law describing estoppel principles in such situations. Invalid securities are now rare, and preference issues are addressed by modern regulatory, corporate and insolvency law, which should not be affected by the STA distinction. See s. 1(3) and Comment. Substantive uniformity with Rev 8 is intended.

The phrase "constating provisions governing the issuer" is intended to capture all provisions governing the issuer's capacity to issue a security, such as a corporation's articles and comparable provisions applicable to trusts, partnerships or other types of issuers.

Definitional cross-references:	"issuer"	s. 1(1)
	"security"	s. 1(1)

Notice

3. (1) For the purposes of this Act, a person has notice of a fact if,

(a) the person has knowledge of it;

(b) the person has received a notice of it; or

(c) information comes to the person's attention under circumstances in which a reasonable person would take cognizance of it.

Giving a notice

(2) A person gives a notice to another person by taking such steps as may be reasonably required to inform the other person in the ordinary course, whether or not the other person comes to know of it.

Receiving a notice

(3) A person receives a notice when,

(a) the notice comes to the person's attention;

(b) in the case of a notice under a contract, the notice is duly delivered to the place of business through which the contract was made; or

(c) the notice is duly delivered to any other place held out by that person as the place for receipt of those notices.

When notice is effective for a transaction

(4) Notice, knowledge or a notice received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting the transaction and, in any event, from the time when it would have been brought to the attention of that individual if the organization had exercised due diligence.

Same

(5) For the purpose of subsection (4), an organization exercises due diligence if it maintains reasonable routines for communicating significant information to the individual conducting the transaction and there is reasonable compliance with those routines.

Same

(6) For the purpose of subsection (4), due diligence does not require an individual acting for the organization to communicate information unless,

(a) that communication is part of the individual's regular duties; or

(b) the individual has reason to know of the transaction and that the transaction would be materially affected by the information.

COMMENT

Source: UCC 1-202

Comparison with previous law: There is no comparable provision in existing Canadian law relating to the transfer of securities. See PPSA sections 68 and 69; Alberta PPSA sections 1(2) and 72.

Explanation: This provision uses different wording but is intended to be substantively uniform with the corresponding provisions of UCC 1-202 and with the existing PPSA provisions. The existing PPSA provisions are not uniform, but appear to mean the same thing as the UCC.

The definition of when a person has notice of a fact in s. 3(1) is intended to mean the same as the UCC version. "Knowledge" is defined in s. 1(1) to mean "actual knowledge". This section does not use the additional terms "notifies" or "notification", which are used in UCC 1-202 when the essential fact is the proper dispatch of the notice, not its receipt. There is no substantive difference—the STA equivalent of "notifies" is "gives a notice" as described in s. 3(2).

When the essential fact is the other party's receipt of the notice, that is stated. Subsection (3) states when a notice is received. This provision is intended to be substantively uniform with UCC 1-202(e), notwithstanding differences in drafting.

Subsections (4) through (6) make clear that notice, knowledge, or a notice, although "received", for instance, by a clerk in Department A of an organization, is effective for a transaction conducted in Department B only from the time when it was or should have been communicated to the individual conducting that transaction. The combined effect of these provisions is intended to be substantively uniform with UCC 1-202(f).

Definitional cross-references:	"communication"	s. 1(1)
	"knowledge"	s. 1(1)
	"person"	s. 1(1)

Obligation of good faith

4. (1) Every contract to which this Act applies and every duty imposed by this Act imposes an obligation of good faith in its performance or enforcement.

Definition of good faith

(2) In this section,

"good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

COMMENT

Source: Subsection (1) is based on UCC 1-304; subsection (2) is based on UCC 1-201(b)(20).

Comparison with previous law: There are no comparable provisions in existing Canadian law relating to the transfer of securities. Subsection (2) is comparable to the definitions of "good faith" in OBCA s. 53(1); ABCA s. 47(2)(i); CBCA s. 48(2); all of which are based on, and similar to, (1962) UCC 1-201(19).

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of the UCC.

This provision sets forth a basic principle running throughout the STA. The principle is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties. The concept is broader than any particular illustration and applies generally, as stated in this section, to the performance or enforcement of every contract or duty within the STA. This section does not support an independent cause of action for failure to perform or enforce in good faith. Rather, this section means that the failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of that contract or makes unavailable, under the particular circumstances, a remedial right or power. This distinction makes it clear that the doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached.

Good faith is defined in subsection (2) for purposes of the application of subsection (1),

which provides that every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement. The sole function of the good faith definition in subsection (2) is to give content to the subsection (1) obligation as it applies to contracts and duties that are governed by the STA. The standard is one of "reasonable commercial standards of fair dealing". The reference to commercial standards makes clear that assessments of conduct are to be made in light of the commercial setting. The substantive rules of the STA have been drafted to take account of the commercial circumstances of the securities holding and processing system. For example, s. 54 provides that a securities intermediary acting on an effective entitlement order, or a broker or other agent acting as a conduit in a securities transaction, is not liable to an adverse claimant, unless the claimant obtained legal process or the intermediary acted in collusion with the wrongdoer. This, and other similar provisions, see s. 91 and s. 97(7), do not depend on notice of adverse claims, because it would impair rather than advance the interest of investors in having a sound and efficient securities clearance and settlement system to require intermediaries to investigate the propriety of the transactions they are processing. The good faith obligation does not supplant the standards of conduct established in provisions of this kind.

In the STA, the definition of good faith is not germane to the question whether a purchaser takes free from adverse claims. The rules on such questions as whether a purchaser who takes in suspicious circumstances is disqualified from protected purchaser status are treated not as an aspect of good faith but directly in the rules of sections 18-22 on notice of adverse claims.

This provision applies to the core duties imposed by the STA upon securities intermediaries in relation to security entitlements, including the duty to:

- "obtain and thereafter maintain a financial asset" in s. 98(1);
- "obtain a payment or distribution made by the issuer" in s. 99(1);
- "exercise rights with respect to a financial asset if directed to do so by an entitlement holder" in s. 100(1);
- "comply with an entitlement order" in s. 101(1); and
- "act at the direction of an entitlement holder" in s. 102(1).

These duties may be satisfied if the intermediary acts "as agreed to by the entitlement holder and the securities intermediary" or, in the absence of such agreement, if the intermediary "exercises due care in accordance with reasonable commercial standards" (see s. 98(4) and subsection (2) of each of s. 99-102). To the extent that these duties are the subject of another statute, regulation or rule (such as securities regulatory law), then s. 103 provides that compliance with such other statute, regulation or rule satisfies

the duty imposed by the STA.

The obligation of good faith provides an over-arching protection for entitlement holders by attaching to the core duties described above, and to the agreements regarding performance of those duties. So, for example, an intermediary could not enforce a standard clause in its account-opening agreement disclaiming all responsibility for performing the core duties, but the parties could validly agree that the intermediary will not be responsible for the custodial risk of holding foreign securities through foreign intermediaries. See para. 4 of the Comment to s. 98, and *Powers v. American Express Financial Advisors* (2000), 82 F. Supp. 2d 448 (D. Md.), *aff'd*, (2000), 43 U.C.C. Rep. Serv. 2d (West) 425 (4th Cir.).

This section does not apply to a government as an issuer of a security issued before the STA came into force: see s. 8(3).

Definitional cross-references: None.

Variation of Act by agreement

5. (1) Subject to subsection (2), the effect of provisions of this Act may be varied by agreement.

Same

(2) The obligations of good faith, diligence, reasonableness and care imposed by this Act may not be disclaimed by agreement, but the parties may by agreement determine the standards by which the performance of such obligations is to be measured so long as such standards are not manifestly unreasonable.

COMMENT

Source: This provision is based on UCC 1-302(a) and (b).

Comparison with previous law: There is no comparable provision in existing Canadian law relating to the transfer of securities.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of the UCC.

This provision states affirmatively that freedom of contract is a principle of the STA: "the

effect" of its provisions may be varied by agreement. Agreement is defined in UCC 1-201(b)(3) to mean "the bargain of the parties in fact as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade...." and a similarly broad meaning is intended here in the Canadian context. The meaning of the statute itself must be found in its text, including its definitions, and in appropriate extrinsic aids; it cannot be varied by agreement. Private parties cannot change the meaning of terms used in the STA, but an agreement can change the legal consequences which would otherwise flow from the provisions of the STA. "Agreement" is defined in the UCC to include the effect given to course of dealing, usage of trade and course of performance (which terms are also expressly defined in UCC 1-303. The UCC thus expressly incorporates into agreements the prior course of dealing and usages of trade, which is sufficiently consistent with modern common-law principles of contractual interpretation that such express codification was unnecessary in the STA. The same meaning is intended. The effect of an agreement on the rights of third parties is left to specific provisions of the STA and to supplementary principles applicable under s. 6.

UCC 1-302(c) says that the presence of "unless otherwise agreed", or similar words, in certain provisions does not imply that the effect of other provisions may not be varied by agreement under that section. That same intent is implicit in the STA.

This principle of freedom of contract is subject to specific exceptions found elsewhere in the STA and to the general exception in subsection (2). Under the exception for "the obligations of good faith, diligence, reasonableness and care imposed by this Act", provisions of the STA prescribing such obligations are not to be disclaimed. However, this provision also recognizes the prevailing practice of having agreements set forth the standards by which due diligence is measured and explicitly provides that, in the absence of a showing that the standards manifestly are unreasonable, the agreement controls.

The operation of this provision is particularly relevant to the core duties imposed by the STA upon securities intermediaries in relation to security entitlements, including the duty to:

- "obtain and thereafter maintain a financial asset" in s. 98(1);
- "obtain a payment or distribution made by the issuer" in s. 99(1);
- "exercise rights with respect to a financial asset if directed to do so by an entitlement holder" in s. 100(1);
- "comply with an entitlement order" in s. 101(1); and
- "act at the direction of an entitlement holder" in s. 102(1).

These duties may be satisfied if the intermediary acts "as agreed to by the entitlement

holder and the securities intermediary" or, in the absence of such agreement, if the intermediary "exercises due care in accordance with reasonable commercial standards" (see s. 98(4) and subsection (2) of each of s. 99-102). To the extent that these duties are the subject of another statute, regulation or rule (such as securities regulatory law), then s. 103 provides that compliance with such other statute, regulation or rule satisfies the duty imposed by the STA.

The obligation of good faith in s. 4 provides an over-arching protection for entitlement holders by attaching to the core duties described above, and to the agreements regarding performance of those duties. So, for example, an intermediary could not enforce a standard clause in its account-opening agreement disclaiming all responsibility for performing the core duties, but the parties could validly agree that the intermediary will not be responsible for the custodial risk of holding foreign securities through foreign intermediaries. See para. 4 of the Comment to s. 98, and *Powers v. American Express Financial Advisors* (2000), 82 F. Supp. 2d 448 (D. Md.), *aff'd*, (2000), 43 U.C.C. Rep. Serv. 2d (West) 425 (4th Cir.).

This section does not apply to a government as an issuer of a security issued before the STA came into force: see s. 8(3).

Definitional cross-references: None.

Principles of law and equity apply

6. Except in so far as they are inconsistent with this Act, the principles of law and equity supplement this Act and continue to apply, including,

(a) the law merchant;

(b) the law relating to the capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion and mistake; and

(c) other validating or invalidating rules of law.

COMMENT

Source: This provision is based on UCC 1-103(b), OPPSA s. 72 and APPSA s. 66(3).

Comparison with previous law: This provision is similar to OPPSA s. 72 and APPSA s. 66(3), but there is no comparable provision in existing Canadian law relating strictly to

the transfer of securities.

Explanation: This provision is intended to be substantively uniform with UCC 1-103(b) and the comparable PPSA provisions, which use slightly different wording but appear to mean the same thing.

This provision indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by the STA. The principle has been stated in more detail and phrasing enlarged to make it clear that the "validating", as well as the "invalidating" causes are included here. "Validating" as used here in conjunction with "invalidating" is not intended as a narrow word confined to original validity of a security under s. 2, but extends to cover any factor which at any time or in any manner renders or helps to render valid any right or transaction.

The listing given in this provision is merely illustrative; no listing could be exhaustive. Nor is the fact that in some sections particular circumstances have led to express reference to other fields of law intended at any time to suggest the negation of the general application of the principles of this section.

The overall purpose of sections 4, 5 and 6 is to enable courts to apply the STA within the appropriate commercial context of particular transactions. Because the STA is intended to be flexible enough to accommodate future developments in commercial practice, some of its provisions are expressed in general terms. That generality may raise concerns about the potential for perverse interpretations of the STA. However, such concerns overlook the fact that courts will not interpret the STA in the abstract, but only within the commercial context of particular transactions, which makes perverse interpretations unlikely.

This section does not apply to a government as an issuer of a security issued before the STA came into force: see s. 8(3).

Definitional cross-references: None.

Clearing agency rules prevail

7. (1) A rule adopted by a clearing agency governing rights and obligations between the clearing agency and its participants or between participants in the clearing agency is effective even if the rule conflicts with this Act or the *Personal Property Security Act* and affects another person who does not consent to the rule.

Limitation

(2) Subsection (1) applies only to a clearing agency that has been recognized or exempted from recognition under section 21.2 of the *Securities Act*.

COMMENT

Source: UCC Rev 8-111

Comparison with previous law: There are no comparable provisions in existing Canadian provincial law dealing with clearing agency rules. Current OBCA s. 53(1) contains a definition of "clearing agency" for the purposes of the book-entry transfer provisions of s. 85, including the "super priority" rule for perfected security interests created pursuant to the clearing agency's contractual arrangements with its participants under OBCA s. 85(1.1). In Canadian federal law, see the *Payment Clearing and Settlement Act*.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-111.

The experience of the past few decades shows that securities holding and settlement practices may develop rapidly, and in unforeseeable directions. Accordingly, it is desirable that the rules of the STA be adaptable both to ensure that commercial law can conform to changing practices and to ensure that commercial law does not operate as an obstacle to developments in securities practice. Even if practices were unchanging, it would not be possible in a general statute to specify in detail the rules needed to provide certainty in the operations of the clearance and settlement system.

The provisions of the STA provide considerable flexibility in the specification of the details of the rights and obligations of participants in the securities holding system by agreement. See sections 98-102 and s. 5. Given the magnitude of the exposures involved in securities transactions, however, it may not be possible for the parties in developing practices to rely solely on private agreements, particularly with respect to matters that might affect others, such as creditors. For example, in order to be fully effective, rules of clearing agencies on the finality or reversibility of securities settlements must not only bind the participants in the clearing agency but also be effective against their creditors.

Section 7 provides that clearing agency rules are effective even if they indirectly affect

third parties, such as creditors of a participant. This provision does not, however, permit rules to be adopted that would govern the rights and obligations of third parties other than as a consequence of rules that specify the rights and obligations of the clearing agency and its participants.

The definition of clearing agency in s. 1(1) covers only entities regulated by a provincial securities regulator that are also (i) regulated by the Bank of Canada under the federal *Payment Clearing and Settlement Act* or (ii) securities and derivatives clearing houses for the purposes of section 13.1 of that Act. The rules of recognized clearing agencies are subject to regulatory oversight by the provincial securities regulator or both the provincial securities regulator and the Bank of Canada.

Subsection (2) makes this provision applicable only to a clearing agency recognized or exempted from recognition under s. 21.2 of the *Securities Act*.

Definitional cross-references: "clearing agency" s. 1(1)

Application to Crown

8. (1) Subject to subsections (2) and (3), this Act applies to the Crown in right of Canada, the Crown in right of Ontario and the Crown in right of any other province of Canada, and any agencies of them.

Crown privileges, immunities

(2) Nothing in this Act shall be construed as affecting any privilege or immunity, at common law, in equity or under any other Act, of the Crown in right of Canada, the Crown in right of Ontario or the Crown in right of any other province of Canada, or of any servant of the Crown.

Securities issued by governments before Act is in force

(3) The provisions of this Act that apply to an issuer of a security do not apply to a government or any agency of it as an issuer in respect of a security issued before this section comes into force, except as otherwise expressly provided in the terms and conditions of the security.

COMMENT

Source: New

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the transfer of securities. The PPSAs apply to the Crown (see PPSA s. 3; Alberta PPSA s. 2). In the U.S., the UCC applies generally to governments and government agencies.

Explanation: Subject to the exceptions described in this provision, the STA applies to the Crown's commercial activities in securities markets. The STA does not affect any Crown privilege or immunity (see s. 8(2)). The STA does not apply to any government or agency of government as an issuer in respect of a security issued before this section comes into force, except as otherwise expressly provided in the terms and conditions of the security. We are not aware that any such security currently provides in its terms and conditions for the application of the STA.

Definitional cross-references:	"government"	s. 1(1)
	"issuer"	s. 1(1)

Existing proceedings

9. This Act does not affect a legal proceeding that was commenced before this section comes into force.

COMMENT

Source: UCC Rev 8-603(a)

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-603(1).

The STA should present few significant transition problems. Although the STA involves significant changes in terminology and analysis, the substantive rules are, in large measure, based upon the current practices and are consistent with results generally intended by market participants and that could be reached, albeit at times with some struggle, by purposive interpretation of the rules of present law. Thus, the new rules can be applied, without significant dislocations, to transactions and events that occurred prior

to enactment.

The enacting provisions should not, whether by applicability, transition, or savings clause language, attempt to provide that previous law continues to apply to "transactions," "events," "rights," "duties," "liabilities," or the like that occurred or accrued before the effective date and that the STA applies to those that occur or accrue after the effective date. A primary reason for the STA and conforming amendments to secured-lending legislation is the concern that previous law could be interpreted or misinterpreted to yield results that impede the safe and efficient operation of the Canadian system for the clearance and settlement of securities transactions. Accordingly, it is not the case that any effort should be made to preserve the applicability of previous law to transactions and events that occurred before the effective date.

Two circumstances warrant continued application of previous law. First, to avoid disruption in the conduct of litigation, this section provides for continued application of previous law to legal proceedings pending before the effective date. Second, there are some limited circumstances in which prior law permitted perfection of security interests by methods that are not provided for in the conforming amendments to secured-lending legislation. The conforming amendments give a secured creditor 4 months after the effective date to continue perfection under the new rules: PPSA s. 84

Part II
General Matters Concerning Securities and Other Financial Assets

Classification of Obligations and Interests

Share, equity interest

10. A share or similar equity interest issued by a corporation, business trust or similar entity is a security.

COMMENT

Source: UCC Rev 8-103(a)

Comparison with previous law: There are no comparable provisions in existing Canadian law relating to transfers of securities.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-103(a).

Sections 10-16 contain rules that supplement the definitions of "financial asset" and "security" in s. 1(1). The s. 1(1) definitions are worded in general terms, because they must be sufficiently comprehensive and flexible to cover the wide variety of investment products that now exist or may develop. The rules in sections 10-16 are intended to foreclose interpretive issues concerning the application of the general definitions to several specific investment products. No implication is made about the application of the s. 1(1) definitions to investment products not covered by sections 10-16.

This section establishes an unconditional rule that ordinary corporate stock is a security. That is so whether or not the particular issue is dealt in or traded on securities exchanges or in securities markets. Thus, shares of closely held corporations are STA securities. This section also refers to equity interests issued by a business trust, which are commonplace in modern securities markets. The term "business trust" is generally understood in commercial practice and has been described as "... a trust for the carrying on of a business in which the interests of the beneficiaries are represented by transferable certificates". (Words & Phrases, Carswell, 1993, at 1-1086, citing Scott, The Law of Trusts (4th ed., 1987 and *Trident Holdings Ltd. v. Danand Investments Ltd.* (1988), 39 B.L.R. 296 at 305, 307, 25 O.A.C. 378, 30 E.T.R. 67, 64 O.R. (2d) 65, 49 D.L.R. (4th) 1 (C.A.) the court per Morden J.A.). The reference to transferable *certificates*

is outdated (and would today be replaced by securities) but the description is otherwise accurate.

UCC Rev 8-103(a) also refers to a joint stock company, which would be captured by the term "corporation" in this section. The words "stock" and "share" are synonymous.

Definitional cross-references:	"corporation"	s. 1(1)
	"security"	s. 1(1)

Mutual fund security

11. (1) A mutual fund security is a security.

Definitions

(2) In this section,

"mutual fund security" means a share, unit or similar equity interest issued by an open-end mutual fund, but does not include an insurance policy, endowment policy or annuity contract issued by an insurance company; ("titre de fonds commun de placement")

"open-end mutual fund" means an entity that makes a distribution to the public of its shares, units or similar equity interests and that carries on the business of investing the consideration it receives for the shares, units or similar equity interests it issues, all or substantially all of which shares, units or similar equity interests are redeemable on the demand of their holders or owners. ("fonds commun de placement à capital variable")

COMMENT

Source: UCC Rev 8-103(b)

Comparison with previous law: There are no comparable provisions in existing Canadian law relating to transfers of securities.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-103(b).

Sections 10-16 contain rules that supplement the definitions of "financial asset" and "security" in s. 1(1). The s. 1(1) definitions are worded in general terms, because they must be sufficiently comprehensive and flexible to cover the wide variety of investment products that now exist or may develop. The rules in sections 10-16 are intended to

foreclose interpretive issues concerning the application of the general definitions to several specific investment products. No implication is made about the application of the s. 1(1) definitions to investment products not covered by sections 10-16.

This section establishes that the STA term "security" includes shares, units or similar equity interests offered to the public by open-end mutual funds. This clarification is prompted principally by the fact that the typical transaction in shares of open-end mutual funds is an issuance or redemption, rather than a transfer of shares from one person to another as is the case with ordinary corporate stock. For similar reasons, the definitions of endorsement, instruction, and entitlement order in s. 1(1) refer to "redemptions" as well as "transfers", to ensure that the STA rules on such matters as signature guarantees (sections 79-84), assurances (sections 87 and 101), and effectiveness (sections 29-32) apply to directions to redeem mutual fund shares. The exclusion of insurance products is needed because some insurance company products, such as annuity contracts and what are commonly known as segregated funds, may resemble securities, but these are not traded under the usual STA mechanics.

Securities issued by an entity that would have been an open-end mutual fund, but for the fact that it did not make a distribution to the public of its shares, units or similar equity interests, can still be STA securities. See the definition of "security" in subsection 1(1) and section 10.

Definitional cross-references: "security" s. 1(1)

Interest in partnership, limited liability company

12. (1) An interest in a partnership or limited liability company is not a security unless,

(a) that interest is dealt in or traded on securities exchanges or in securities markets;

(b) the terms of that interest expressly provide that the interest is a security for the purposes of this Act; or

(c) that interest is a mutual fund security within the meaning of section 11.

Same

(2) An interest in a partnership or limited liability company is a financial asset if it is held in a securities account.

Definition

(3) In this section,

"limited liability company" means an unincorporated association, other than a partnership, formed under the laws of another jurisdiction, that grants to each of its members limited liability with respect to the liabilities of the association.

COMMENT

Source: UCC Rev 8-103(c)

Comparison with previous law: There are no comparable provisions in existing Canadian law relating to transfers of securities.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-103(c).

Sections 10-16 contain rules that supplement the definitions of "financial asset" and "security" in s. 1(1). The s. 1(1) definitions are worded in general terms, because they must be sufficiently comprehensive and flexible to cover the wide variety of investment products that now exist or may develop. The rules in sections 10-16 are intended to foreclose interpretive issues concerning the application of the general definitions to several specific investment products. No implication is made about the application of the s. 1(1) definitions to investment products not covered by sections 10-16.

This section is designed to foreclose interpretive questions that might otherwise be raised by the application of the "of a type" language used in the definition of "security" in s. 1(1) to partnership interests. This section establishes the general rule that partnership interests or shares of limited liability companies are not STA securities unless they are in fact dealt in or traded on securities exchanges or in securities markets. The issuer, however, may explicitly "opt-in" by specifying that the interests or shares are securities for the purposes of the STA. Partnership interests or shares of limited liability companies are included in the broader term "financial asset". Thus, if they are held through a securities account, the indirect holding system rules of Part 6 apply, and the interest of a person who holds them through such an account is a security entitlement.

Limited liability companies are common in the U.S. but cannot be created under existing Canadian law. Nonetheless, a share in a limited liability company could become subject to Canadian law so this STA provision eliminates any uncertainty about how such share should be characterized. This provision overrides s. 10 in relation to such a share.

Definitional cross-references:	"financial asset"	s. 1(1) and s. 1(2)
	"mutual fund security"	s. 11
	"securities account"	s. 1(1)
	"security"	s. 1(1)

Bill of exchange, promissory note

13. A bill of exchange or promissory note to which the *Bills of Exchange Act* (Canada) applies is not a security, but is a financial asset if it is held in a securities account.

COMMENT

Source: OBCA s. 53(2)

Comparison with previous law: See OBCA s. 53(2). There are no comparable provisions in the ABCA or CBCA.

Explanation: Sections 10-16 contain rules that supplement the definitions of "financial asset" and "security" in s. 1(1). The s. 1(1) definitions are worded in general terms, because they must be sufficiently comprehensive and flexible to cover the wide variety of investment products that now exist or may develop. The rules in sections 10-16 are intended to foreclose interpretive issues concerning the application of the general definitions to several specific investment products. No implication is made about the application of the s. 1(1) definitions to investment products not covered by sections 10-16.

This section makes clear that bills and notes under the *Bills of Exchange Act* are not securities, but are financial assets for the purposes of the STA if they are held in a securities account. In effect, this provision states that the direct holding system rules in the STA do not apply to bills and notes, so they will continue to be governed by the *Bills of Exchange Act*. However, the indirect holding system rules in STA Part 6 do apply, provided the bill or note is held in a securities account.

There is a notable difference between Canadian and U.S. law on this point. In the UCC, the direct transfer of a bill or note that meets the definition of "negotiable instrument" under UCC Article 3 and also meets the definition of "security certificate" under UCC Article 8 is governed by Article 8 and not Article 3. See UCC 8-103(d) and 3-102(a). In

Canada, the direct transfer of a security that also meets the definition of a bill or note is governed by the *Bills of Exchange Act*, which has some important implications (e.g. the liability of an endorser).

With respect to the indirect holding system, U.S. law and Canadian law will be the same in that a negotiable instrument such as a bill or note that is held in a securities account is a financial asset, so that the rules of STA Part 6 will apply.

Definitional cross-references:	"financial asset"	s. 1(1) and s. 1(2)
	"securities account"	s. 1(1)
	"security"	s. 1(1)

Depository bill, depository note

14. A depository bill or depository note to which the *Depository Bills and Notes Act* (Canada) applies is not a security, but is a financial asset if it is held in a securities account.

COMMENT

Source: New.

Comparison with previous law: See OBCA s. 53(2). There are no comparable provisions in the ABCA or CBCA.

Explanation: Sections 10-16 contain rules that supplement the definitions of "financial asset" and "security" in s. 1(1). The s. 1(1) definitions are worded in general terms, because they must be sufficiently comprehensive and flexible to cover the wide variety of investment products that now exist or may develop. The rules in sections 10-16 are intended to foreclose interpretive issues concerning the application of the general definitions to several specific investment products. No implication is made about the application of the s. 1(1) definitions to investment products not covered by sections 10-16.

This section makes clear that depository bills and notes under the *Depository Bills and Notes Act* are not securities, but are financial assets for the purposes of the STA if they are held in a securities account. In effect, this provision states that the direct holding system rules in the STA do not apply to depository bills and notes, so the direct transfer of such instruments to CDS will continue to be governed by the *Depository Bills and Notes Act*. However, the indirect holding system rules in STA Part 6 do apply, provided

the depository bill or note is held in a securities account. Accordingly, certain provisions of the current *Depository Bills and Notes Act*, including sections 8 and 9, will no longer serve any purpose.

There is a notable difference between Canadian and U.S. law on this point. In the UCC, the direct transfer of a bill or note that meets the definition of "negotiable instrument" under UCC Article 3 and also meets the definition of "security certificate" under UCC Article 8 is governed by Article 8 and not Article 3. See UCC 8-103(d) and 3-102(a). In Canada, the direct transfer of a security that also meets the definition of a depository bill or note is governed by the *Depository Bills and Notes Act*.

Definitional cross-references:	"financial asset"	s. 1(1) and s. 1(2)
	"securities account"	s. 1(1)
	"security"	s. 1(1)

Clearing house option

15. (1) A clearing house option or similar obligation is not a security, but is a financial asset.

Definition

(2) In this section,

"clearing house option" means a clearing house option as defined in the *Personal Property Security Act*.

COMMENT

Source: UCC Rev 8-103(e)

Comparison with previous law: There are no comparable provisions in existing Canadian law relating to transfers of securities.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-103(e).

Sections 10-16 contain rules that supplement the definitions of "financial asset" and "security" in s. 1(1). The s. 1(1) definitions are worded in general terms, because they must be sufficiently comprehensive and flexible to cover the wide variety of investment products that now exist or may develop. The rules in sections 10-16 are intended to foreclose interpretive issues concerning the application of the general definitions to

several specific investment products. No implication is made about the application of the s. 1(1) definitions to investment products not covered by sections 10-16.

This section is included to clarify the treatment of investment products such as traded stock options, which are treated as financial assets but not securities. Thus, the indirect holding system rules of Part 6 apply, but the direct holding system rules of Parts 3, 4, and 5 do not.

This section and the STA definition of "security" in s. 1(1) correct a defect in the existing OBCA definition of security, which includes "any right to acquire such a share, participation, interest or obligation". Certain rights to acquire a security (i.e. a right against an ordinary issuer) should be captured by the definition of "security" because those rights trade like other securities and are appropriately dealt with by the rules of STA Parts 3, 4, and 5. However, different considerations apply to options issued and cleared through the Canadian Derivatives Clearing Corporation (CDCC). CDCC functions as a central counter-party to each options trade and each option is a contractual right against CDCC—not an interest or an obligation of a separate issuer. The rules of STA Parts 3, 4 and 5 do not well describe the obligations and rights of CDCC. On the other hand, the rules of Part 6, and the related PPSA rules on security interests and priorities, do provide a workable legal framework for the commercial law analysis for the rights of the participants in the options market. Accordingly, publicly traded securities options issued by a clearing house are included within the definition of "financial asset" but not "security".

"Clearing house option" is defined in the PPSA.

Definitional cross-references:	"clearing agency"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"security"	s. 1(1)

Futures contract

16. (1) A futures contract is not a security or a financial asset.

Definition

(2) In this section,

"futures contract" means a futures contract as defined in the *Personal Property Security Act*.

COMMENT

Source: UCC Rev 8-103(f)

Comparison with previous law: There are no comparable provisions in existing Canadian law relating to transfers of securities.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-103(f).

Sections 10-16 contain rules that supplement the definitions of "financial asset" and "security" in s. 1(1). The s. 1(1) definitions are worded in general terms, because they must be sufficiently comprehensive and flexible to cover the wide variety of investment products that now exist or may develop. The rules in sections 10-16 are intended to foreclose interpretive issues concerning the application of the general definitions to several specific investment products. No implication is made about the application of the s. 1(1) definitions to investment products not covered by sections 10-16.

This section excludes futures contracts from all of the STA. However, the PPSA rules on security interests in investment property do apply to security interests in futures contracts. "Futures contract" is defined in the PPSA and the STA cross-references the PPSA definition.

Definitional cross-references:	"financial asset"	s. 1(1) and s. 1(2)
	"security"	s. 1(1)

Acquisition of Financial Assets or Interests in Them

Acquisition of financial assets
Security

17. (1) A person acquires a security or an interest in a security under this Act if,

(a) the person is a purchaser to whom a security is delivered under section 68; or

(b) the person acquires a security entitlement to the security under section 95.

Other financial assets

(2) A person acquires a financial asset, other than a security, or an interest in such a financial asset under this Act if the person acquires a security entitlement to the financial asset.

Rights on acquisition of security entitlement

(3) A person who acquires a security entitlement to a security or other financial asset has the rights specified in Part VI, but is a purchaser of any security, security entitlement or other financial asset held by a securities intermediary only to the extent provided in section 97.

Operation of Act re other laws

(4) Unless the context of another statute, law, regulation, rule or agreement shows that a different meaning is intended, a person who is required by that statute, law, regulation, rule or agreement to transfer, deliver, present, surrender, exchange or otherwise put in the possession of another person a security or other financial asset satisfies that requirement by causing the other person to acquire an interest in the security or other financial asset as set out in subsection (1) or (2).

COMMENT

Source: UCC Rev 8-104

Comparison with previous law: There are no comparable provisions in existing Canadian law relating to transfers of securities.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-104.

This section lists the ways in which interests in securities and other financial assets are acquired under the STA. In that sense, it describes the scope of the STA.

Subsection (1) describes the two ways that a person may acquire a security or interest therein under the STA: (1) by delivery [s. 68], and (2) by acquiring a security entitlement [s. 95]. Each of these methods is described in detail in the relevant substantive provisions of the STA. Part 4, beginning with the definition of "delivery" in s. 68, describes how interests in securities are acquired in the direct holding system. Part 6, beginning with the rules of s. 95 on how security entitlements are acquired, describes how interests in securities are acquired in the indirect holding system.

Subsection (2) specifies how a person may acquire an interest under the STA in a financial asset other than a security. The STA deals with financial assets other than securities only insofar as they are held in the indirect holding system. For example, a bankers' acceptance falls within the definition of "financial asset", so if it is held through a securities account the entitlement holder's right to it is a security entitlement governed by Part 6. The bankers' acceptance itself, however, is a bill of exchange governed by the *Bills of Exchange Act* or a depository bill governed by the *Depository Bills and Notes Act*, not by the STA. Thus, the provisions of Parts 3, 4, and 5 of the STA that deal with the rights of direct holders of securities are not applicable. The *Bills of Exchange Act* or the *Depository Bills and Notes Act*, not the STA, specifies how one acquires a direct interest in a bankers' acceptance. If a bankers' acceptance is delivered to a clearing agency to be held for the account of the clearing agency's participants, the clearing agency becomes the holder of the bankers' acceptance under the *Bills of Exchange Act* or the *Depository Bills and Notes Act* rules specifying how such instruments are transferred. The rights of the clearing agency's participants, however, are governed by Part 6 of the STA.

The distinction in usage in the STA between the term "security" (and its correlatives "security certificate" and "uncertificated security") on the one hand, and "security entitlement" on the other, corresponds to the distinction between the direct and indirect holding systems. For example, with respect to certificated securities that can be held either directly or through intermediaries, obtaining possession of a security certificate and acquiring a security entitlement are both means of holding the underlying security. For many other purposes, there is no need to draw a distinction between the means of holding. For purposes of commercial law analysis, however, the form of holding may make a difference. Where an item of property can be held in different ways, the rules on how one deals with it, including how one transfers it or how one grants a security interest in it, differ depending on the form of holding.

Although a security entitlement is a means of holding the underlying security or other financial asset, a person who has a security entitlement does not have any direct claim to a specific asset in the possession of the securities intermediary. Subsection (3) provides explicitly that a person who acquires a security entitlement is a "purchaser" of any security, security entitlement, or other financial asset held by the securities intermediary only in the sense that under s. 97 a security entitlement is treated as a *sui generis* form of property interest.

Subsection (4) is designed to ensure that parties will retain their expected legal rights and duties under the STA. One of the major changes made by the STA is that the rules

for the indirect holding system are stated in terms of the "security entitlements" held by investors, rather than speaking of them as holding direct interests in securities. Subsection (4) is designed as a translation rule to eliminate problems of co-ordination of terminology, and facilitate the continued use of systems for the efficient handling of securities and financial assets through securities intermediaries and clearing agencies. The efficiencies of a securities intermediary or clearing agency are, in part, dependent on the ability to transfer securities credited to securities accounts in the intermediary or clearing agency to the account of an issuer, its agent, or other person by book entry in a manner that permits exchanges, redemptions, conversions, and other transactions (which may be governed by pre-existing or new agreements, constating documents, or other instruments) to occur and to avoid the need to withdraw from immobilization in an intermediary or clearing agency physical securities in order to deliver them for such purposes. Existing corporate charters, indentures and like documents may require the 'presentation,' 'surrender,' 'delivery,' or 'transfer' of securities or security certificates for purposes of exchange, redemption, conversion or other reason. Likewise, documents may use a wide variety of terminology to describe, in the context for example of a tender or exchange offer, the means of putting the offeror or the issuer or its agent in possession of the security. Subsection (4) takes the place of provisions of prior law which could be used to reach the legal conclusion that book-entry transfers are equivalent to physical delivery to the person to whose account the book entry is credited.

See also s. 1(3).

Definitional cross-references:	"financial asset"	s. 1(1) and s. 1(2)
	"person"	s. 1(1)
	"purchaser"	s. 1(1)
	"security"	s. 1(1)
	"security entitlement"	s. 1(1)
	"security interest"	s. 1(1)

Notice of Adverse Claims

What constitutes notice of adverse claim

18. A person has notice of an adverse claim if,

(a) the person knows of the adverse claim;

(b) the person is aware of facts sufficient to indicate that there is a significant probability that the adverse claim exists and

deliberately avoids information that would establish the existence of the adverse claim; or

(c) the person has a duty, imposed by statute or regulation, to investigate whether an adverse claim exists and the investigation, if carried out, would establish the existence of the adverse claim.

COMMENT

Source: UCC Rev 8-105(a)

Comparison with previous law: There are no comparable provisions in existing Canadian law relating to transfers of securities.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-105(a).

1. The rules specifying whether adverse claims can be asserted against persons who acquire securities or security entitlements, s. 70, s. 96 and s.104, provide that one is protected against an adverse claim only if one takes without notice of the claim. This section defines notice of an adverse claim.

The definition of "notice" in s. 3—which provides that a person has notice of a fact if "information comes to the person's attention under circumstances in which a reasonable person would take cognizance of it"—does not apply to the interpretation of "notice of adverse claims". The s. 3 definition of "notice" does, however, apply to usages of that term and its cognates in the STA in contexts other than notice of adverse claims.

2. This section must be interpreted in light of the definition of "adverse claim" in s. 1(1), and the fact that Canadian PPSAs continue to include cut-off rules that are not included in UCC Rev 9, such as OPPSA s. 28(6) and APPSA s. 30(9). "Adverse claim" does not include all circumstances in which a third party has a property interest in securities, but only those situations where a security is transferred in violation of the claimant's property interest. Therefore, awareness that someone other than the transferor has a property interest is not notice of an adverse claim. The transferee must be aware that the transfer violates the other party's property interest. If A holds securities in which B has some form of property interest, and A transfers the securities to C, C may know that B has an interest, but infer that A is acting in accordance with A's obligations to B. The mere fact that C knew that B had a property interest does not mean that C had notice of an

adverse claim. Whether C had notice of an adverse claim depends on whether C had sufficient awareness that A was acting in violation of B's property rights. The rule in s. 19 is a particularization of this general principle.

3. Section 18(a) provides that a person has notice of an adverse claim if the person has knowledge of the adverse claim. Knowledge is defined in s. 1(1) as actual knowledge.

4. Section 18(b) provides that a person has notice of an adverse claim if the person is aware of a significant probability that an adverse claim exists and deliberately avoids information that might establish the existence of the adverse claim. This is intended to codify the "willful blindness" test that has been applied in such cases. See *May v. Chapman*, 16 M. & W. 355, 153 Eng. Rep. 1225 (1847); *Goodman v. Simonds*, 61 U.S. 343; (1857) *Sweeny v. Bank of Montreal* (1885), 12 S.C.R. 661, *aff'd* 12 App. Cas. 617; *Bank Leu AG v. Gaming Lottery Corp.* (2001), 29 B.L.R. (3d) 68 (Ont. S.C.J. [Commercial List]), *aff'd* [2003] O.J. No. 3213 (C.A.).

The first prong of the willful blindness test of s. 18(b) turns on whether the person is aware of facts sufficient to indicate that there is a significant probability that an adverse claim exists. The "awareness" aspect necessarily turns on the actor's state of mind. Whether facts known to a person make the person aware of a "significant probability" that an adverse claim exists turns on facts about the world and the conclusions that would be drawn from those facts, taking account of the experience and position of the person in question. A particular set of facts might indicate a significant probability of an adverse claim to a professional with considerable experience in the usual methods and procedures by which securities transactions are conducted, even though the same facts would not indicate a significant probability of an adverse claim to a non-professional.

The second prong of the willful blindness test of s. 18(b) turns on whether the person "deliberately avoids information" that would establish the existence of the adverse claim. The test is the character of the person's response to the information the person has. The question is whether the person deliberately failed to seek further information because of concern that suspicions would be confirmed.

Application of the "deliberate avoidance" test to a transaction by an organization focuses on the knowledge and the actions of the individual or individuals conducting the transaction on behalf of the organization. Thus, an organization that purchases a security is not willfully blind to an adverse claim unless the officers or agents who conducted that purchase transaction are willfully blind to the adverse claim. Under the two prongs of the willful blindness test, the individual or individuals conducting a transaction must know of facts indicating a substantial probability that the adverse claim

exists and deliberately fail to seek further information that might confirm or refute the indication. For this purpose, information known to individuals within an organization who are not conducting or aware of a transaction, but not forwarded to the individuals conducting the transaction, is not pertinent in determining whether the individuals conducting the transaction had knowledge of a substantial probability of the existence of the adverse claim. Compare sections 3(4)-(6). An organization may also "deliberately avoid information" if it acts to preclude or inhibit transmission of pertinent information to those individuals responsible for the conduct of purchase transactions.

Sections 18(a) and (b) are intended to set a subjective test, substantively uniform with the interpretation of the corresponding provisions of UCC Rev 8-105 in *Decker v. Yorkton Securities, Inc.*, 106 Cal. App. 4th 1315, 131 Cal. Rptr. 2d 645, 2003 Cal. App. LEXIS 391, 2003 Cal. Daily Op. Service 2313, 2003 D.A.R. 2903 (Cal. App. 1st Dist. 2003).

5. Section 18(c) provides that a person has notice of an adverse claim if the person would have learned of the adverse claim by conducting an investigation that is required by other statute or regulation. This rule applies only if there is some other statute or regulation that explicitly requires persons dealing with securities to conduct some investigation. In the U.S., federal securities laws require that brokers and banks, in certain specified circumstances, check with a stolen securities registry to determine whether securities offered for sale or pledge have been reported as stolen. Canada currently has no comparable statutory or regulatory requirements to investigate whether an adverse claim exists. The Official Comment to Rev 8-105 notes that, in the U.S., failure to comply with the obligation imposed by U.S. federal securities laws was held to constitute notice of an adverse claim even prior to the enactment of Rev 8-105, and s. 18(c) is intended to make clear that the same result would follow in Canada if a statute or regulation explicitly required some investigation.

Definitional cross-references:	"adverse claim"	s. 1(1)
	"knows"	s. 1(1)
	"person"	s. 1(1)

Notice of transfer

19. (1) Having knowledge that a financial asset, or an interest in a financial asset, is being or has been transferred by a representative does not impose any duty of inquiry into the rightfulness of the transaction and is not notice of an adverse claim.

Same

(2) Despite subsection (1), a person has notice of an adverse claim if that person knows that,

(a) a representative has transferred a financial asset, or an interest in a financial asset, in a transaction; and

(b) the transaction is, or the proceeds of the transaction are being used,

(i) for the individual benefit of the representative, or

(ii) otherwise in breach of a duty owed by the representative.

COMMENT

Source: UCC Rev 8-105(b)

Comparison with previous law: See OBCA s. 70(2); ABCA s. 60(2); CBCA s. 61(2); all of which are based on, and similar to, (1962) UCC 8-304(2).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-105(b).

Section 19 provides explicitly for some situations involving purchase from one described or identifiable as a representative. Knowledge of the existence of the representative relation is not enough in itself to constitute "notice of an adverse claim" that would disqualify the purchaser from protected purchaser status. A purchaser may take a security on the inference that the representative is acting properly. Knowledge that a security is being transferred to an individual account of the representative or that the proceeds of the transaction will be paid into that account is not sufficient to constitute "notice of an adverse claim", but knowledge that the proceeds will be applied to the personal indebtedness of the representative is. See *State Bank of Binghamton v. Bache*, 162 Misc. 128, 293 N.Y.S. 667 (1937). There appear to be no Canadian cases dealing with this provision in existing law. There is no substantive change from existing law.

Definitional cross-references:		
	"adverse claim"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"knows"	s. 1(1)
	"notice of an adverse claim"	sections 18-22
	"person"	s. 1(1)

"representative"	s. 1(1)

Delay

20. An act or event that creates a right to immediate performance of the principal obligation represented by a security certificate, or that sets a date on or after which a security certificate is to be presented or surrendered for redemption or exchange, does not by itself constitute notice of an adverse claim except in the case of a transfer that takes place more than,

(a) one year after a date set for presentation or surrender for redemption or exchange; or

(b) six months after a date set for payment of money against presentation or surrender of the security certificate, if money was available for payment on that date.

COMMENT

Source: UCC Rev 8-105(c)

Comparison with previous law: See OBCA s. 70(3); ABCA s. 61; CBCA s. 62; all of which are based on, and similar to, (1962) UCC 8-305.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-105(c).

Section 20 specifies whether a purchaser of a "stale" security is charged with notice of adverse claims, and therefore disqualified from protected purchaser status under s. 70. The fact of "staleness" is viewed as notice of certain defects after the lapse of stated periods, but the maturity of the security does not operate automatically to affect holders' rights. The periods of time here stated are shorter than those appearing in the provisions of the STA on staleness as notice of defects or defenses of an issuer (s. 61) since a purchaser who takes a security after funds or other securities are available for its redemption has more reason to suspect claims of ownership than issuer's defenses. An owner will normally turn in a security rather than transfer it at such a time. Of itself, a default never constitutes notice of a possible adverse claim. To provide otherwise would not tend to drive defaulted securities home and would serve only to disrupt current financial markets where many defaulted securities are actively traded. Unpaid or overdue coupons attached to a bond do not bring it within the operation of this

subsection, though they may be relevant under the general test of notice of adverse claims in s. 18. There appear to be no Canadian cases dealing with this provision in existing law. There is no substantive change from existing law.

Definitional cross-references:	"adverse claim"	s. 1(1)
	"security certificate"	s. 1(1)

Statement on security certificate

21. (1) A purchaser of a certificated security has notice of an adverse claim if the security certificate,

(a) whether in bearer form or registered form, has been endorsed "for collection" or "for surrender" or for some other purpose not involving a transfer; or

(b) is in bearer form and has on it an unambiguous statement that it is the property of a person other than the transferor.

Same

(2) For the purposes of clause (1) (b), the mere writing of a name on a security certificate does not by itself constitute an unambiguous statement that the security certificate is the property of a person other than the transferor.

COMMENT

Source: UCC Rev 8-105(d)

Comparison with previous law: See OBCA s. 70(1); ABCA s. 60(1); CBCA s. 61(1); all of which are based on, and similar to, (1962) UCC 8-304(1).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-105(d).

Section 21 provides the owner of a certificated security with a means of protection while a security certificate is being sent in for redemption or exchange. The owner may endorse it "for collection" or "for surrender", and this constitutes notice of the owner's claims, under this section. There appear to be no Canadian cases dealing with this provision in existing law. There is no substantive change from existing law.

Definitional cross-references:	"certificated security"	s. 1(1)
	"bearer form"	s. 1(1)
	"endorsement"	s. 1(1)
	"person"	s. 1(1)
	"purchaser"	s. 1(1)
	"registered form"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)

Registration of financing statement

22. The registration of a financing statement under the *Personal Property Security Act* is not notice of an adverse claim.

COMMENT

Source: UCC Rev 8-105(e)

Comparison with previous law: There is no comparable provision in existing Canadian law relating strictly to the transfer of securities. See PPSA s. 46(5) and Alberta PPSA s. 47, which provide that registration of a financing statement is not constructive notice or knowledge to third parties of its existence or contents.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-105(e). In Canada, previous law such as PPSA s. 28(6) and (7), as well as the current provisions of s. 28(6)-(10), deal specifically with notice of security interests and cut-off rules applicable to security interests. The UCC does not contain comparable provisions, relying solely upon the Rev 8 adverse claim cut-off rules to reach the same result. The PPSA cut-off rules provide an extra degree of certainty and do not detract from the operation of the STA adverse claim cut-off rules. Although this provision may rarely be relied upon (as a result of the operation of the PPSA cut-off rules), it is stated to provide certainty on this issue and uniformity between the operation of the Rev 8 and STA adverse claim cut-off rules.

Definitional cross-references:	"financial asset"	s. 1(1) and s. 1(2)
	"security interest"	s. 1(1)

Purchaser's control of certificated security

23. (1) A purchaser has control of a certificated security that is in bearer form if the certificated security is delivered to the purchaser.

Same

(2) A purchaser has control of a certificated security that is in registered form if the certificated security is delivered to the purchaser and,

(a) the security certificate is endorsed to the purchaser or in blank by an effective endorsement; or

(b) the security certificate is registered in the name of the purchaser at the time of the original issue or registration of transfer by the issuer.

COMMENT

Source: UCC Rev 8-106(a) and (b)

Comparison with previous law: There is no comparable provision in existing Canadian law.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-106(a) and (b).

The concept of "control" plays a key role in various provisions dealing with the rights of purchasers, including secured parties. See s. 70 (protected purchasers); s. 97(7) (purchasers from securities intermediaries); s. 104 (purchasers of security entitlements from entitlement holders); PPSA s. 22.1(1) (perfection of security interests); PPSA s. 30.1 (priorities among conflicting security interests).

Obtaining "control" means that the purchaser has taken whatever steps are necessary, given the manner in which the securities are held, to place itself in a position where it can have the securities sold, without further action by the owner.

Section 23(1) provides that a purchaser obtains "control" with respect to a certificated security in bearer form by taking "delivery", as defined in s. 68. Subsection (2) provides

that a purchaser obtains "control" with respect to a certificated security in registered form by taking "delivery", as defined in s. 68, provided that the security certificate has been endorsed to the purchaser or in blank. Section 68 provides that delivery of a certificated security occurs when the purchaser obtains possession of the security certificate, or when an agent for the purchaser (other than a securities intermediary) either acquires possession or acknowledges that the agent holds for the purchaser.

Definitional cross-references:		
	"bearer form"	s. 1(1)
	"certificated security"	s. 1(1)
	"delivery"	s. 1(1) and s. 68
	"endorsement"	s. 1(1)
	"purchaser"	s. 1(1)

Purchaser's control of uncertificated security

24. (1) A purchaser has control of an uncertificated security if,

(a) the uncertificated security is delivered to the purchaser; or

(b) the issuer has agreed that the issuer will comply with instructions that are originated by the purchaser without the further consent of the registered owner.

Same

(2) A purchaser to whom subsection (1) applies in relation to an uncertificated security has control of the uncertificated security even if the registered owner retains the right,

(a) to make substitutions for the uncertificated security;

(b) to originate instructions to the issuer; or

(c) to otherwise deal with the uncertificated security.

COMMENT

Source: UCC Rev 8-106(c) and (f)

Comparison with previous law: There is no comparable provision in existing Canadian law.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-106(c) and (f).

The concept of "control" plays a key role in various provisions dealing with the rights of purchasers, including secured parties. See s. 70 (protected purchasers); s. 97(7) (purchasers from securities intermediaries); s. 104 (purchasers of security entitlements from entitlement holders); PPSA s. 22.1(1) (perfection of security interests); PPSA s. 30.1 (priorities among conflicting security interests).

Obtaining "control" means that the purchaser has taken whatever steps are necessary, given the manner in which the securities are held, to place itself in a position where it can have the securities sold, without further action by the owner.

Section 24 specifies the means by which a purchaser can obtain control over uncertificated securities which the transferor holds directly. Two mechanisms are possible.

Under clause (1)(a), securities can be "delivered" to a purchaser. Section 68(2) provides that "delivery" of an uncertificated security occurs when the purchaser becomes the registered holder. So far as the issuer is concerned, the purchaser would then be entitled to exercise all rights of ownership. See s. 64. As between the parties to a purchase transaction, however, the rights of the purchaser are determined by their contract. Arrangements covered by this paragraph are analogous to arrangements in which bearer certificates are delivered to a secured party—so far as the issuer or any other parties are concerned, the secured party appears to be the outright owner, although it is in fact holding as collateral property that belongs to the debtor.

Under clause (1)(b), a purchaser has control if the issuer has agreed to act on the instructions of the purchaser, even though the owner remains listed as the registered owner. The issuer, of course, would be acting wrongfully against the registered owner if it entered into such an agreement without the consent of the registered owner. Section 27 makes this point explicit. The clause (1)(b) provision makes it possible for issuers to offer a service akin to the registered pledge device of the 1978 version of UCC Article 8, without mandating that all issuers offer that service: see s. 27(3).

For a purchaser to have "control" under s. 24(1)(b), it is essential that the issuer actually be a party to the agreement. If a debtor gives a secured party a power of attorney authorizing the secured party to act in the name of the debtor, but the issuer does not specifically agree to this arrangement, the secured party does not have "control" within the meaning of s. 24(1)(b) because the issuer is not a party to the agreement. The secured party does not have control under s. 24(1)(a) because, although the power of attorney might give the secured party authority to act on the debtor's behalf as an agent,

the secured party has not actually become the registered owner.

The term "control" is used in a particular defined sense. The requirements for obtaining control are set out in this section and sections 23, 25 and 26. The concept is not to be interpreted by reference to similar concepts in other bodies of law. In particular, the requirements for "possession" derived from the common law of pledge are not to be used as a basis for interpreting clause (1)(b) or s. 25(1)(b). Those provisions are designed to supplant the concepts of "constructive possession" and the like. A principal purpose of the "control" concept is to eliminate the uncertainty and confusion that results from attempting to apply common law possession concepts to modern securities holding practices.

The key to the control concept is that the purchaser has the ability to have the securities sold or transferred without further action by the transferor. There is no requirement that the powers held by the purchaser be exclusive. For example, in a secured lending arrangement, if the secured party wishes, it can allow the debtor to retain the right to make substitutions, to direct the disposition of the uncertificated security or otherwise to give instructions. Section 24(2) is included to make clear the general point stated in s. 24(1) that the test of control is whether the purchaser has obtained the requisite power, not whether the debtor has retained other powers. There is no implication that retention by the debtor of powers other than those mentioned in subsection (2) is inconsistent with the purchaser having control. Nor is there a requirement that the purchaser's powers be unconditional, provided that further consent of the transferor is not a condition.

Definitional cross-references:		
	"delivery"	s. 1(1) and s. 68
	"instruction"	s. 1(1)
	"issuer"	s. 1(1)
	"purchaser"	s. 1(1)
	"secured party"	s. 1(1)
	"security interest"	s. 1(1)
	"uncertificated security"	s. 1(1)

Purchaser's control of security entitlement

25. (1) A purchaser has control of a security entitlement if,

(a) the purchaser becomes the entitlement holder;

(b) the securities intermediary has agreed that it will comply with entitlement orders that are originated by the purchaser without the further consent of the entitlement holder; or

(c) another person has control of the security entitlement on behalf of the purchaser or, having previously obtained control of the security entitlement, acknowledges that the person has control on behalf of the purchaser.

Same

(2) A purchaser to whom subsection (1) applies in relation to a security entitlement has control of the security entitlement even if the entitlement holder retains the right,

(a) to make substitutions for the security entitlement;

(b) to originate entitlement orders to the securities intermediary; or

(c) to otherwise deal with the security entitlement.

COMMENT

Source: UCC Rev 8-106(d) and (f)

Comparison with previous law: There is no comparable provision in existing Canadian law.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-106(d) and (f).

The concept of "control" plays a key role in various provisions dealing with the rights of purchasers, including secured parties. See s. 70 (protected purchasers); s. 97(7) (purchasers from securities intermediaries); s. 104 (purchasers of security entitlements from entitlement holders); PPSA s. 22.1(1) (perfection of security interests); PPSA s. 30.1(priorities among conflicting security interests).

Obtaining "control" means that the purchaser has taken whatever steps are necessary, given the manner in which the securities are held, to place itself in a position where it can have the securities sold, without further action by the owner.

Section 25(1) specifies the means by which a purchaser can obtain control of a security entitlement. Three mechanisms are possible, analogous to those provided in s. 24(1) for uncertificated securities. Under clause (1)(a), a purchaser has control if it is the entitlement holder. This clause would apply whether the purchaser holds through the same intermediary that the debtor used, or has the securities position transferred to its own intermediary. Clause (1)(b) provides that a purchaser has control if the securities

intermediary has agreed to act on entitlement orders originated by the purchaser if no further consent by the entitlement holder is required. Under clause (1)(b), control may be achieved even though the original entitlement holder remains as the entitlement holder. Finally, a purchaser may obtain control under clause (1)(c) if another person has control and the person acknowledges that it has control on the purchaser's behalf. Control under clause (1)(c) parallels the delivery of certificated securities and uncertificated securities under s. 68. Of course, the acknowledging person cannot be the debtor.

This section specifies only the minimum requirements that such an arrangement must meet to confer "control"; the details of the arrangement can be specified by agreement. The arrangement might cover all of the positions in a particular account or subaccount, or only specified positions. There is no requirement that the control party's right to give entitlement orders be exclusive. The arrangement might provide that only the control party can give entitlement orders, or that either the entitlement holder or the control party can give entitlement orders. See s. 28.

The following examples illustrate the application of s. 25(1):

Example 1. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha Bank also has an account with Able. Debtor instructs Able to transfer the shares to Alpha Bank, and Able does so by crediting the shares to Alpha's account. Alpha has control of the 1000 shares under clause (1)(a). Although Debtor may have become the beneficial owner of the new securities entitlement, as between Debtor and Alpha, Able has agreed to act on Alpha's entitlement orders because, as between Able and Alpha, Alpha has become the entitlement holder. See s. 100.

Example 2. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha does not have an account with Able. Alpha uses Beta as its securities custodian. Debtor instructs Able to transfer the shares to Beta, for the account of Alpha, and Able does so. Alpha has control of the 1000 shares under clause (1)(a). As in Example 1, although Debtor may have become the beneficial owner of the new securities entitlement, as between Debtor and Alpha, Beta has agreed to act on Alpha's entitlement orders because, as between Beta and Alpha, Alpha has become the entitlement holder.

Example 3. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Debtor, Able, and Alpha enter into an agreement under which Debtor will continue to

receive dividends and distributions, and will continue to have the right to direct dispositions, but Alpha also has the right to direct dispositions. Alpha has control of the 1000 shares under clause (1)(b).

Example 4. Able & Co., a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Agency. Able causes Clearing Agency to transfer the shares into Alpha's account at Clearing Agency. Alpha has control of the 1000 shares under clause (1)(a).

Example 5. Able & Co., a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Agency. Alpha does not have an account with Clearing Agency. It holds its securities through Beta Bank, which does have an account with Clearing Agency. Able causes Clearing Agency to transfer the shares into Beta's account at Clearing Agency. Beta credits the position to Alpha's account with Beta. Alpha has control of the 1000 shares under clause (1)(a).

Example 6. Able & Co. a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Agency. Able causes Clearing Agency to transfer the shares into a pledge account, pursuant to an agreement under which Able will continue to receive dividends, distributions, and the like, but Alpha has the right to direct dispositions. As in Example 3, Alpha has control of the 1000 shares under clause (1)(b).

Example 7. Able & Co. a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Agency. Able, Alpha, and Clearing Agency enter into an agreement under which Clearing Agency will act on instructions from Alpha with respect to the XYZ Co. stock carried in Able's account, but Able will continue to receive dividends, distributions, and the like, and will also have the right to direct dispositions. As in Example 3, Alpha has control of the 1000 shares under clause (1)(b).

Example 8. Able & Co. a securities dealer, holds a wide range of securities through its account at Clearing Agency. Able enters into an arrangement with Alpha Bank pursuant to which Alpha provides financing to Able secured by securities identified as the collateral on lists provided by Able to Alpha on a daily or other periodic basis. Able, Alpha, and Clearing Agency enter into an agreement under which Clearing Agency agrees that if at any time Alpha directs Clearing Agency to do so, Clearing Agency will transfer any securities from Able's account at Alpha's instructions. Because Clearing

Agency has agreed to act on Alpha's instructions with respect to any securities carried in Able's account, at the moment that Alpha's security interest attaches to securities listed by Able, Alpha obtains control of those securities under clause (1)(b). There is no requirement that Clearing Agency be informed of which securities Able has pledged to Alpha.

Example 9. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Beta Bank agrees with Alpha to act as Alpha's collateral agent with respect to the security entitlement. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Beta also has the right to direct dispositions. Because Able has agreed that it will comply with entitlement orders originated by Beta without further consent by Debtor, Beta has control of the security entitlement (see Example 3). Because Beta has control on behalf of Alpha, Alpha also has control under clause (1)(c). It is not necessary for Able to enter into an agreement directly with Alpha or for Able to be aware of Beta's agency relationship with Alpha.

For a purchaser to have "control" under s. 25(1)(b), it is essential that the securities intermediary actually be a party to the agreement. If a debtor gives a secured party a power of attorney authorizing the secured party to act in the name of the debtor, but the securities intermediary does not specifically agree to this arrangement, the secured party does not have "control" within the meaning of s. 25(1)(b) because the securities intermediary is not a party to the agreement. The secured party does not have control under s. 25(1)(a) because, although the power of attorney might give the secured party authority to act on the debtor's behalf as an agent, the secured party has not actually become the entitlement holder.

The term "control" is used in a particular defined sense. The requirements for obtaining control are set out in this section and sections 23, 24 and 26. The concept is not to be interpreted by reference to similar concepts in other bodies of law. In particular, the requirements for "possession" derived from the common law of pledge are not to be used as a basis for interpreting clause (1)(b) or s. 24(1)(b). Those provisions are designed to supplant the concepts of "constructive possession" and the like. A principal purpose of the "control" concept is to eliminate the uncertainty and confusion that results from attempting to apply common law possession concepts to modern securities holding practices.

The key to the control concept is that the purchaser has the ability to have the securities sold or transferred without further action by the transferor. There is no requirement that

the powers held by the purchaser be exclusive. For example, in a secured lending arrangement, if the secured party wishes, it can allow the debtor to retain the right to make substitutions, to direct the disposition of the financial asset to which the debtor has a security entitlement or otherwise to give entitlement orders. Subsection 25(2) is included to make clear the general point stated in s. 25(1) that the test of control is whether the purchaser has obtained the requisite power, not whether the debtor has retained other powers. There is no implication that retention by the debtor of powers other than those mentioned in subsection (2) is inconsistent with the purchaser having control. Nor is there a requirement that the purchaser's powers be unconditional, provided that further consent of the entitlement holder is not a condition.

Example 10. Debtor grants to Alpha Bank and to Beta Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. By agreement among the parties, Alpha's security interest is senior and Beta's is junior. Able agrees to act on the entitlement orders of either Alpha or Beta. Alpha and Beta each has control under clause (1)(b). Moreover, Beta has control notwithstanding a term of Able's agreement to the effect that Able's obligation to act on Beta's entitlement orders is conditioned on Alpha's consent. The crucial distinction is that Able's agreement to act on Beta's entitlement orders is not conditioned on Debtor's further consent.

Example 11. Debtor grants to Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Able agrees to act on the entitlement orders of Alpha, but Alpha's right to give entitlement orders to the securities intermediary is conditioned on the Debtor's default. Alternatively, Alpha's right to give entitlement orders is conditioned upon Alpha's statement to Able that Debtor is in default. Because Able's agreement to act on Alpha's entitlement orders is not conditioned on Debtor's further consent, Alpha has control of the securities entitlement under either alternative.

In many situations, it will be better practice for both the securities intermediary and the purchaser to insist that any conditions relating in any way to the entitlement holder be effective only as between the purchaser and the entitlement holder. That practice would avoid the risk that the securities intermediary could be caught between conflicting assertions of the entitlement holder and the purchaser as to whether the conditions in fact have been met. Nonetheless, the existence of unfulfilled conditions effective against the intermediary would not preclude the purchaser from having control.

Definitional cross-references: "entitlement holder" s. 1(1)

	"person"	s. 1(1)
	"purchaser"	s. 1(1)
	"secured party"	s. 1(1)
	"securities intermediary"	s. 1(1)
	"security entitlement"	s. 1(1)
	"security interest"	s. 1(1)

Securities intermediary's control of security entitlement

26. If an interest in a security entitlement is granted by the entitlement holder to the entitlement holder's own securities intermediary, the securities intermediary has control of the security entitlement.

COMMENT

Source: UCC Rev 8-106(e)

Comparison with previous law: There is no comparable provision in existing Canadian law.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-106(e).

The concept of "control" plays a key role in various provisions dealing with the rights of purchasers, including secured parties. See s. 70 (protected purchasers); s. 97(7) (purchasers from securities intermediaries); s. 104 (purchasers of security entitlements from entitlement holders); PPSA s. 22.1(1) (perfection of security interests); PPSA s. 30.1 (priorities among conflicting security interests).

Obtaining "control" means that the purchaser has taken whatever steps are necessary, given the manner in which the securities are held, to place itself in a position where it can have the securities sold, without further action by the owner.

Section 26 provides that if an interest in a security entitlement is granted by an entitlement holder to the securities intermediary through which the security entitlement is maintained, the securities intermediary has control. A common transaction covered by this provision is a margin loan from a broker to its customer. This section does not apply where financing is provided by a separate entity. In that situation, the customer, creditor

and intermediary must agree that the intermediary will act upon the creditor's instructions without the further consent of the customer, which gives the creditor control under s. 25(1)(b).

Definitional cross-references:	"entitlement holder"	s. 1(1)
	"securities intermediary"	s. 1(1)
	"security entitlement"	s. 1(1)
	"security interest"	s. 1(1)

Agreement re control of uncertificated security

27. (1) An issuer shall not enter into an agreement of the kind referred to in clause 24 (1) (b) without the consent of the registered owner.

Same

(2) An issuer that has entered into an agreement of the kind referred to in clause 24 (1) (b) is not required to confirm the existence of the agreement to another person unless requested to do so by the registered owner.

Same

(3) An issuer is not required to enter into an agreement of the kind referred to in clause 24 (1) (b) even if the registered owner so requests.

COMMENT

Source: UCC Rev 8-106(g)

Comparison with previous law: There is no comparable provision in existing Canadian law.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-106(g).

This provision explicitly states that an issuer of an uncertificated security must have the consent of the registered owner before entering into a control agreement; that the issuer need not confirm the existence of such an agreement to another party unless requested to do so by the registered owner; and that an issuer is not required to enter into a control agreement even if the registered owner so requests. Section 28 states parallel rules applicable to securities intermediaries.

Definitional cross-references:	"issuer"	s. 1(1)
	"uncertificated security"	s. 1(1)

Agreement re control of security entitlement

28. (1) A securities intermediary shall not enter into an agreement of the kind referred to in clause 25 (1) (b) without the consent of the entitlement holder.

Same

(2) A securities intermediary that has entered into an agreement of the kind referred to in clause 25 (1) (b) is not required to confirm the existence of the agreement to another person unless requested to do so by the entitlement holder.

Same

(3) A securities intermediary is not required to enter into an agreement of the kind referred to in clause 25 (1) (b) even if the entitlement holder so requests.

COMMENT

Source: UCC Rev 8-106(g)

Comparison with previous law: There is no comparable provision in existing Canadian law.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-106(g).

This provision explicitly states that a securities intermediary must have the consent of the entitlement holder before entering into a control agreement; that the securities intermediary need not confirm that existence of such an agreement to another party unless requested to do so by the entitlement holder; and that a securities intermediary is not required to enter into a control agreement even if the entitlement holder so requests. Section 27 states parallel rules applicable to issuers of uncertificated securities.

Definitional cross-references:	"entitlement holder"	s. 1(1)
	"securities intermediary"	s. 1(1)

29. An endorsement, instruction or entitlement order is effective if,

(a) it is made by the appropriate person;

(b) it is made by a person who, in the case of an endorsement or instruction, has the power under the law of agency to transfer the security, or in the case of an entitlement order, has the power under the law of agency to transfer the financial asset, on behalf of the appropriate person, including,

(i) in the case of an instruction referred to in clause 24(1)(b), the person who has control of the uncertificated security, or

(ii) in the case of an entitlement order referred to in clause 25(1) (b), the person who has control of the security entitlement; or

(c) the appropriate person has ratified it or is otherwise precluded from asserting its ineffectiveness.

COMMENT

Source: UCC Rev 8-107(b)

Comparison with previous law: Section 29(c) is, to a limited extent, similar to previous OBCA s. 76(1); ABCA s. 67; CBCA s. 68; all of which are based on, and similar to, (1962) UCC 8-311(a).

Previous law was unnecessarily complex and confusing (see OBCA s. 76; ABCA s. 67; CBCA s. 68). The previous definition of "appropriate person" included a trustee or fiduciary even though that person was no longer serving in that capacity and an endorsement by that person was, arguably, unauthorized. Previous law stated that an issuer who registered the transfer of a security upon an unauthorized endorsement was liable for improper registration but the owner of a security might be precluded from asserting the ineffectiveness of an unauthorized endorsement.

The STA uses two concepts: the defined term "appropriate person", and when an endorsement, instruction or entitlement order is "effective". This section and sections 30-

32 specify when an endorsement, instruction or entitlement order is "effective". The use of these two concepts enables the STA to more clearly state the legal effect of an endorsement, instruction or entitlement order in various circumstances.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-107(b).

1. This section, together with the definition of "appropriate person" in s. 1(1) and sections 30-32, define two concepts, "appropriate person" and "effective". Effectiveness is a broader concept than appropriate person. For example, if a security or securities account is registered in the name of Mary Roe, Mary Roe is the "appropriate person", but an endorsement, instruction, or entitlement order made by John Doe is "effective" if, under agency or other law, Mary Roe is precluded from denying Doe's authority. Treating these two concepts separately facilitates a more precise statement of the STA rules describing the legal effect of an endorsement, instruction, or entitlement order. For example, a securities intermediary is protected against liability if it acts on an effective entitlement order, but has a duty to comply with an entitlement order only if it is originated by an appropriate person. See s. 54 and s. 101.

One important application of the "effectiveness" concept is in the direct holding system rules on the rights of purchasers. A purchaser of a certificated security in registered form can qualify as a protected purchaser who takes free from adverse claims under s. 70 only if the purchaser obtains "control". Section 23(2)(a) provides that a purchaser of a certificated security in registered form obtains control if there has been an "effective" endorsement.

2. This section sets out the general rule that an endorsement, instruction, or entitlement order is effective if it is made by the appropriate person or by a person who has power to transfer under agency law or if the appropriate person is precluded from denying its effectiveness. The control rules in s. 24 and s. 25 provide for arrangements where a person who holds securities through a securities intermediary, or holds uncertificated securities directly, enters into a control agreement giving the secured party the right to initiate entitlement orders or instructions. Section 29(b) states explicitly that an entitlement order or instruction initiated by a person who has obtained such a control agreement is "effective".

Sections 30-32 supplement the general rule of s. 29 on effectiveness.

Definitional cross-references:	"appropriate person"	s. 1(1)
	"endorsement"	s. 1(1)

	"entitlement order"	s. 1(1)
	"fiduciary"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"instruction"	s. 1(1)
	"secured party"	s. 1(1)
	"security certificate"	s. 1(1)
	"security entitlement"	s. 1(1)
	"uncertificated security"	s. 1(1)

Effectiveness of endorsement, etc., made by representative

30. An endorsement, instruction or entitlement order made by a representative is effective even if,

(a) the representative has failed to comply with a controlling instrument or with the law of the jurisdiction governing the representative's rights and duties, including any law requiring the representative to obtain court approval of the transaction; or

(b) the representative's action in making the endorsement, instruction or entitlement order or using the proceeds of the transaction is otherwise a breach of duty owed by the representative.

COMMENT

Source: UCC Rev 8-107(c)

Comparison with previous law: See OBCA s. 73(6); ABCA s. 64(10); CBCA s. 65(10); all of which are based on, and similar to (1962) UCC 8-308(7). In previous law, this provision addressed endorsements only and was located together with other rules governing transfers of securities held in the direct holding system. This provision now addresses endorsements, instructions and entitlement orders, so it is relocated to this Part of the STA dealing with general matters.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-107(c).

Section 30 provides that an endorsement, instruction, or entitlement order made by a representative is effective even though the representative's action is a violation of duties.

The following example illustrates this subsection:

Example 1. Certificated securities are registered in the name of John Doe. Doe dies and Mary Roe is appointed executor. Roe endorses the security certificate and transfers it to a purchaser in a transaction that is a violation of her duties as executor.

Roe's endorsement is effective, because Roe is the appropriate person under the definition of "appropriate person" in s. 1(1). This is so even though Roe's transfer violated her obligations as executor. The policies of free transferability of securities that underlie the STA dictate that neither a purchaser to whom Roe transfers the securities nor the issuer who registers transfer should be required to investigate the terms of the will to determine whether Roe is acting properly. Although Roe's endorsement is effective under this section, her breach of duty may be such that her beneficiary has an adverse claim to the securities that Roe transferred. The question whether that adverse claim can be asserted against purchasers is governed not by this section but by s. 70. Under s. 91, the issuer has no duties to an adverse claimant unless the claimant obtains legal process enjoining the issuer from registering transfer.

Definitional cross-references:		
	"endorsement"	s. 1(1)
	"entitlement order"	s. 1(1)
	"instruction"	s. 1(1)
	"representative"	s. 1(1)

Endorsement, etc., remains effective

31. If a security is registered in the name of or specially endorsed to a person described as a representative, or if a securities account is maintained in the name of a person described as a representative, an endorsement, instruction or entitlement order made by the person is effective even if the person is no longer serving in that capacity.

COMMENT

Source: UCC Rev 8-107(d)

Comparison with previous law: See paragraph (b) of the definition of "appropriate person" in OBCA s. 53(1); ABCA s. 64(1)(b); CBCA s. 65(1)(b); all of which are based on, and similar to, (1962) UCC 8-308(3)(c).

Explanation: This provision is intended to be substantively uniform with the

corresponding provision of Rev 8-107(d).

Section 31 deals with cases where a security or a securities account is registered in the name of a person specifically designated as a representative. The following example illustrates this subsection:

Example 1. Certificated securities are registered in the name of "John Jones, trustee of the Smith Family Trust". John Jones is removed as trustee and Martha Moe is appointed successor trustee. The securities, however, are not reregistered, but remain registered in the name of "John Jones, trustee of the Smith Family Trust". Jones endorses the security certificate and transfers it to a purchaser.

Section 38 provides that an endorsement by John Jones as trustee is effective even though Jones is no longer serving in that capacity. Since the securities were registered in the name of "John Jones, trustee of the Smith Family Trust" a purchaser, or the issuer when called upon to register transfer, should be entitled to assume without further inquiry that Jones has the power to act as trustee for the Smith Family Trust.

Note that s. 31 does not apply to a case where the security or securities account is registered in the name of principal rather than the representative as such. The following example illustrates this point:

Example 2. Certificated securities are registered in the name of John Doe. John Doe dies and Mary Roe is appointed executor. The securities are not reregistered in the name of Mary Roe as executor. Later, Mary Roe is removed as executor and Martha Moe is appointed as her successor. After being removed, Mary Roe endorses the security certificate that is registered in the name of John Doe and transfers it to a purchaser.

Mary Roe's endorsement is not made effective by s. 31, because the securities were not registered in the name of Mary Roe as representative. A purchaser or the issuer registering transfer should be required to determine whether Roe has power to act for John Doe. Purchasers and issuers can protect themselves in such cases by requiring signature guaranties. See sections 79-84.

Definitional cross-references:	"endorsement"	s. 1(1)
	"entitlement order"	s. 1(1)
	"instruction"	s. 1(1)
	"representative"	s. 1(1)
	"securities account"	s. 1(1)

Date when effectiveness is determined

32. (1) The effectiveness of an endorsement, instruction or entitlement order is determined as of the date that the endorsement, instruction or entitlement order is made.

Not made ineffective by change of circumstances

(2) An endorsement, instruction or entitlement order does not become ineffective by reason of any later change of circumstances.

COMMENT

Source: UCC Rev 8-107(e)

Comparison with previous law: See OBCA s. 73(5); ABCA s. 64(2); CBCA s. 65(2); all of which are based on, and similar to, (1962) UCC 8-308(6). In previous law, this provision addressed endorsements only and was located together with other rules governing transfers of securities held in the direct holding system. This provision now addresses endorsements, instructions and entitlement orders, so it is relocated to this Part of the STA dealing with general matters.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-107(e).

Section 32 provides that the effectiveness of an endorsement, instruction, or entitlement order is determined as of the date it is made. The following example illustrates this subsection:

Example 1. Certificated securities are registered in the name of John Doe. John Doe dies and Mary Roe is appointed executor. Mary Roe endorses the security certificate that is registered in the name of John Doe and transfers it to a purchaser. After the endorsement and transfer, but before the security certificate is presented to the issuer for registration of transfer, Mary Roe is removed as executor and Martha Moe is appointed as her successor.

Mary Roe's endorsement is effective, because at the time Roe endorsed she was the appropriate person under the definition of "appropriate person" in s. 1(1). Her later removal as executor does not render the endorsement ineffective. Accordingly, the issuer would not be liable for registering the transfer. See s. 91.

Definitional cross-references:	"endorsement"	s. 1(1)
	"entitlement order"	s. 1(1)
	"instruction"	s. 1(1)
	"representative"	s. 1(1)
	"securities account"	s. 1(1)

Warranties Applicable to Direct Holdings

Warranties on transfer of certificated security

33. A person who transfers a certificated security to a purchaser for value warrants to the purchaser and, if the transfer is by endorsement, also warrants to any subsequent purchaser, that,

(a) the security certificate is genuine and has not been materially altered;

(b) the transferor does not know of any fact that might impair the validity of the security;

(c) there is no adverse claim to the security;

(d) the transfer does not violate any restriction on transfer;

(e) if the transfer is by endorsement, the endorsement is made by the appropriate person or, if the endorsement is by an agent, the agent has actual authority to act on behalf of the appropriate person; and

(f) the transfer is otherwise effective and rightful.

COMMENT

Source: UCC Rev 8-108(a)

Comparison with previous law: See OBCA s. 71(2); ABCA s. 62(2); CBCA s. 63(2); all of which are based on and similar to (1962) 8-306(2), which derives from s. 11 of the *Uniform Stock Transfer Act* of 1909. This provision has been relocated so that it can be grouped together with parallel provisions dealing with warranties given in the context of other types of transactions.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-108(a).

This section deals with certain warranties made by a person who transfers a certificated security to a purchaser for value. Section 33 (c), (d), and (e) make explicit several key points that are implicit in the general warranty of s. 33(f) that the transfer is effective and rightful.

This section provides that, in addition to making warranties to a purchaser for value, an endorser makes warranties to any subsequent purchaser. This is merely the explicit statement of what is implicit under previous law. Under previous law, the warranty was given separately by each transferor so that, if an endorsement was defective, the resultant claim would flow back through the chain of transferors until it reached the endorser.

Under s. 5 the warranty provisions apply unless otherwise agreed and the parties may enter into express agreements to allocate the risks of possible defects. Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be breached in such a case.

Definitional cross-references:		
	"adverse claim"	s. 1(1)
	"appropriate person"	s. 1(1)
	"certificated security"	s. 1(1)
	"endorsement"	s. 1(1)
	"person"	s. 1(1)
	"purchaser"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)
	"valid"	s. 2
	"value"	s. 1(1) and s. 55

Warranties on transfer of uncertificated security

34. (1) A person who originates an instruction for registration of transfer of an uncertificated security to a purchaser for value warrants to the purchaser that,

(a) the instruction is made by the appropriate person or, if the instruction is made by an agent, the agent has actual authority to act on behalf of the appropriate person;

(b) the security is valid;

(c) there is no adverse claim to the security; and

(d) at the time that the instruction is presented to the issuer,

(i) the purchaser will be entitled to the registration of transfer,

(ii) the transfer will be registered by the issuer free from all liens, security interests, restrictions and claims other than those specified in the instruction,

(iii) the transfer will not violate any restriction on transfer, and

(iv) the transfer will otherwise be effective and rightful.

Same

(2) A person who transfers an uncertificated security to a purchaser for value and does not originate an instruction in connection with the transfer warrants to the purchaser that,

(a) the security is valid;

(b) there is no adverse claim to the security;

(c) the transfer does not violate any restriction on transfer; and

(d) the transfer is otherwise effective and rightful.

COMMENT

Source: UCC Rev 8-108(b) and (c)

Comparison with previous law: There are no comparable provisions in existing Canadian law relating to uncertificated securities.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-108(b) and (c).

Section 34 sets forth the warranties made to a purchaser for value by one who originates an instruction. These warranties are quite similar to those made by one transferring a

certificated security, s. 33, the principal difference being the absolute warranty of validity. If upon receipt of the instruction the issuer should dispute the validity of the security, the burden of proving validity is upon the transferor. Subsection (2) provides for the limited circumstances in which an uncertificated security could be transferred without an instruction, see s. 68(2)(b).

Under s. 5 the warranty provisions apply unless otherwise agreed and the parties may enter into express agreements to allocate the risks of possible defects. Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be breached in such a case.

Definitional cross-references:		
	"adverse claim"	s. 1(1)
	"appropriate person"	s. 1(1)
	"instruction"	s. 1(1)
	"issuer"	s. 1(1)
	"person"	s. 1(1)
	"purchaser"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)
	"security interest"	s. 1(1)
	"uncertificated security"	s. 1(1)
	"valid"	s. 2
	"value"	s. 1(1) and s. 55

Warranties on endorsement of security certificate

35. A person who endorses a security certificate warrants to the issuer that,

(a) there is no adverse claim to the security; and

(b) the endorsement is effective

COMMENT

Source: UCC Rev 8-108(d)

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with transfers of securities. This provision states explicitly the result that was implicit in the application of OBCA s. 71(1) and (2); ABCA s. 62(1) and (2); CBCA s. 63(1) and (2); all of which are based on and similar to (1962) 8-306(1) and (2), which

derive from s. 11 of the Uniform Stock Transfer Act of 1909.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-108(d).

Section 35 gives the issuer the benefit of the warranties of an endorser on those matters not within the issuer's knowledge. The warranties given to an issuer by an endorser in this section are merely the explicit statement of warranties that were implicit under previous law. Under previous law, each transferor of a certificated security, starting with the endorser, gave warranties to each purchaser for value and, eventually, a purchaser gave warranties to the issuer upon presentation for registration of transfer. In the event of a breach, the issuer would claim against the last transferor, who would claim back against the previous transferor, and so on, until the claim reached the endorser.

Under s. 5 the warranty provisions apply unless otherwise agreed and the parties may enter into express agreements to allocate the risks of possible defects. Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be breached in such a case.

Definitional cross-references:		
	"adverse claim"	s. 1(1)
	"endorsement"	s. 1(1)
	"issuer"	s. 1(1)
	"person"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)

Warranties on instruction re uncertificated security

36. A person who originates an instruction for the registration of transfer of an uncertificated security warrants to the issuer that,

(a) the instruction is effective; and

(b) at the time that the instruction is presented to the issuer, the purchaser will be entitled to the registration of transfer.

COMMENT

Source: UCC Rev 8-108(e)

Comparison with previous law: There are no comparable provisions in existing Canadian law relating to uncertificated securities.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-108(e).

Section 36 gives the issuer of an uncertificated security the benefit of the warranties of an originator on those matters not within the issuer's knowledge. The warranties given to an issuer by an originator under this section parallel those given by an endorser under s. 35.

Under s. 5 the warranty provisions apply unless otherwise agreed and the parties may enter into express agreements to allocate the risks of possible defects. Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be breached in such a case.

Definitional cross-references:		
	"instruction"	s. 1(1)
	"issuer"	s. 1(1)
	"person"	s. 1(1)
	"purchaser"	s. 1(1)
	"uncertificated security"	s. 1(1)

Warranty on presentation of security certificate

37. A person who presents a certificated security for the registration of transfer or for payment or exchange warrants to the issuer that the person is entitled to the registration, payment or exchange, but a purchaser for value and without notice of adverse claims to whom transfer is registered warrants to the issuer only that the person has no knowledge of any unauthorized signature in a necessary endorsement.

COMMENT

Source: UCC Rev 8-108(f)

Comparison with previous law: See OBCA s. 71(1); ABCA s. 62(1); CBCA s. 63(1); all of which are based on, and similar to, (1962) UCC 8-306(1).

Explanation: This provision is intended to be substantively uniform with the

corresponding provision of Rev 8-108(f).

Section 37 limits the warranties made by a purchaser for value without notice whose presentation of a security certificate is defective in some way but to whom the issuer does register transfer. The effect is to deny the issuer a remedy against such a person unless at the time of presentation the person had knowledge of an unauthorized signature in a necessary endorsement. The issuer can protect itself by refusing to make the transfer or, if it registers the transfer before it discovers the defect, by pursuing its remedy against a signature guarantor.

Under s. 5 the warranty provisions apply unless otherwise agreed and the parties may enter into express agreements to allocate the risks of possible defects. Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be breached in such a case.

Definitional cross-references:		
	"adverse claim"	s. 1(1)
	"certificated security"	s. 1(1)
	"endorsement"	s. 1(1)
	"issuer"	s. 1(1)
	"person"	s. 1(1)
	"purchaser"	s. 1(1)
	"value"	s. 1(1) and s. 55

Warranties by agent delivering certificated security

38. If,

(a) a person acts as agent of another person in delivering a certificated security to a purchaser;

(b) the identity of the principal was known to the person to whom the security certificate was delivered; and

(c) the security certificate delivered by the agent was received by the agent from the principal or from another person at the direction of the principal,

the person delivering the security certificate warrants, to the purchaser, only that the delivering person has authority to act for the principal and does not know of any adverse claim to the certificated security.

COMMENT

Source: UCC Rev 8-108(g)

Comparison with previous law: See OBCA s. 71(3); ABCA s. 62(3); CBCA s. 63(3); all of which are based on, and similar to, (1962) UCC 8-306(3).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-108(g).

Section 38 eliminates all substantive warranties in the relatively unusual case of a delivery of certificated security by an agent of a disclosed principal where the agent delivers the exact certificate that it received from or for the principal.

Under s. 5 the warranty provisions apply unless otherwise agreed and the parties may enter into express agreements to allocate the risks of possible defects. Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be breached in such a case.

Definitional cross-references:		
	"adverse claim"	s. 1(1)
	"certificated security"	s. 1(1)
	"delivery"	s. 1(1) and s. 68
	"person"	s. 1(1)
	"purchaser"	s. 1(1)
	"security certificate"	s. 1(1)

Warranties on redelivery of security certificate

39. A secured party who redelivers a security certificate received, or after payment and on order of the debtor delivers the security certificate to another person, makes only the warranties of an agent set out in section 38.

COMMENT

Source: UCC Rev 8-108(h)

Comparison with previous law: See OBCA s. 71(4); ABCA s. 62(4); CBCA s. 63(4); all of which are based on, and similar to, (1962) UCC 8-306(4).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-108(h).

Section 39 limits the warranties given by a secured party who redelivers a certificate.

Under s. 5 the warranty provisions apply unless otherwise agreed and the parties may enter into express agreements to allocate the risks of possible defects. Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be breached in such a case.

Definitional cross-references:	"delivery"	s. 4 and s. 79
	"person"	s. 1(1)
	"secured party"	s. 1(1)
	"security certificate"	s. 1(1)

Broker's warranties

40. (1) Except as otherwise provided in section 38, a broker acting for a customer makes to the issuer and a purchaser the warranties set out in sections 33 to 37.

Same

(2) A broker that delivers a security certificate to the broker's customer makes to the customer the warranties set out in section 33 and has the rights and privileges of a purchaser provided under sections 33, 38 and 39.

Same

(3) A broker that causes the broker's customer to be registered as the owner of an uncertificated security makes to the customer the warranties set out in section 34 and has the rights and privileges of a purchaser provided under section 34.

Additional warranties

(4) The warranties of and in favour of the broker acting as an agent are in addition to applicable warranties given by and in favour of the customer.

COMMENT

Source: UCC Rev 8-108(i)

Comparison with previous law: See OBCA s. 71(5); ABCA s. 62(5); CBCA s. 63(5); all of which are based on, and similar to, (1962) UCC 8-306(5).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-108(i).

Section 40 specifies the warranties of brokers in the more common scenarios.

Under s. 5 the warranty provisions apply unless otherwise agreed and the parties may enter into express agreements to allocate the risks of possible defects. Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be breached in such a case.

Definitional cross-references:		
	"broker"	s. 1(1)
	"delivery"	s. 1(1) and s. 68
	"issuer"	s. 1(1)
	"purchaser"	s. 1(1)
	"security certificate"	s. 1(1)
	"uncertificated security"	s. 1(1)

Warranties Applicable to Indirect Holdings

Warranties on entitlement order

41. A person who originates an entitlement order to a securities intermediary warrants to the securities intermediary,

(a) that the entitlement order is made by the appropriate person or, if the entitlement order is made by an agent, that the agent has actual authority to act on behalf of the appropriate person; and

(b) that there is no adverse claim to the security entitlement.

COMMENT

Source: UCC Rev 8-109(a)

Comparison with previous law: There are no comparable provisions in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-109(a).

Section 41 provides that a person who originates an entitlement order warrants to the securities intermediary that the order is authorized, and warrants the absence of adverse claims.

The warranties specified in this section may be modified by agreement. See s. 5.

Definitional cross-references:	"adverse claim"	s. 1(1)
	"appropriate person"	s. 1(1)
	"entitlement holder"	s. 1(1)
	"entitlement order"	s. 1(1)
	"person"	s. 1(1)
	"security entitlement"	s. 1(1)
	"securities intermediary"	s. 1(1)

Warranties on security credited to securities account

42. (1) A person who delivers a security certificate to a securities intermediary for credit to a securities account makes to the securities intermediary the warranties set out in section 33.

Same

(2) A person who originates an instruction with respect to an uncertificated security directing that the uncertificated security be credited to a securities account makes to the securities intermediary the warranties set out in section 34.

COMMENT

Source: UCC Rev 8-109(b)

Comparison with previous law: There are no comparable provisions in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-109(b).

Section 42 specifies the warranties that are given when a person who holds securities directly has the holding converted into indirect form. A person who delivers a certificate to a securities intermediary or originates an instruction for an uncertificated security gives to the securities intermediary the transfer warranties under s. 33 or s. 34. If the securities intermediary in turn delivers the certificate to a higher level securities intermediary, it gives the same warranties.

The warranties specified in this section may be modified by agreement. See s. 5.

Definitional cross-references:	"delivery"	s. 1(1) and s. 68
	"person"	s. 1(1)
	"security entitlement"	s. 1(1)
	"securities account"	s. 1(1)
	"securities intermediary"	s. 1(1)
	"security certificate"	s. 1(1)
	"uncertificated security"	s. 1(1)

Securities intermediary's warranties

43. (1) If a securities intermediary delivers a security certificate to its entitlement holder, the securities intermediary makes to the entitlement holder the warranties set out in section 33.

Same

(2) If a securities intermediary causes its entitlement holder to be registered as the owner of an uncertificated security, the securities intermediary makes to the entitlement holder the warranties set out in section 34.

COMMENT

Source: UCC Rev 8-109(c)

Comparison with previous law: There are no comparable provisions in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-109(c).

Section 43 states the warranties that a securities intermediary gives when a customer who has been holding securities in an account with the securities intermediary requests that certificates be delivered or that uncertificated securities be registered in the customer's name. The warranties are the same as those that brokers make with respect to securities that the brokers sell to or buy on behalf of the customers. See s. 40.

The warranties specified in this section may be modified by agreement. See s. 5.

Definitional cross-references:	"delivery"	s. 1(1) and s. 68
	"entitlement holder"	s. 1(1)
	"securities intermediary"	s. 1(1)
	"security certificate"	s. 1(1)
	"uncertificated security"	s. 1(1)

Conflict of Laws

Law governing validity of security

44. (1) The validity of a security is governed by the following laws:

1. If the issuer is incorporated under a law of Canada, the law, other than the conflict of law rules, of Canada.
2. If the issuer is the Crown in right of Canada, the law, other than the conflict of law rules, of Canada.
3. If the issuer is the Crown in right of a province in Canada, the law, other than the conflict of law rules, of the province.

4. If the issuer is the Commissioner of a territory in Canada, the law, other than the conflict of law rules, of the territory.
5. In any other case, the law, other than the conflict of law rules, of the jurisdiction under which the issuer is incorporated or otherwise organized.

Law governing other matters re securities

(2) The law, other than the conflict of law rules, of the issuer's jurisdiction governs,

(a) the rights and duties of the issuer with respect to the registration of transfer;

(b) the effectiveness of the registration of transfer by the issuer;

(c) whether the issuer owes any duties to an adverse claimant to a security; and

(d) whether an adverse claim can be asserted against a person,

(i) to whom the transfer of a certificated or uncertificated security is registered, or

(ii) who obtains control of an uncertificated security.

Issuer may specify law of another jurisdiction

(3) The following issuers may specify the law of another jurisdiction as the law governing the matters referred to in clauses (2) (a) to (d):

1. An issuer incorporated or otherwise organized under the law of Ontario.
2. The Crown in right of Ontario.

Law governing enforceability of security

(4) Whether a security is enforceable against an issuer despite a defence or defect described in sections 57 to 59 is governed by the following laws:

1. If the issuer is incorporated under a law of Canada, the law, other than the conflict of law rules, of the province or territory in Canada in which the issuer has its registered or head office.
2. If the issuer is the Crown in right of Canada, the law, other than the conflict of law rules, of the issuer's jurisdiction.
3. If the issuer is the Crown in right of a province in Canada, the law, other than the conflict of law rules, of the province.
4. If the issuer is the Commissioner of a territory in Canada, the law, other than the conflict of law rules, of the territory.
5. In any other case, the law, other than the conflict of law rules, of the jurisdiction under which the issuer is incorporated or otherwise organized.

Definition

(5) In this section,

"issuer's jurisdiction" means the jurisdiction determined in accordance with the following rules:

1. If the issuer is incorporated under a law of Canada, the province or territory in Canada in which the issuer has its registered or head office or, if permitted by the law of Canada, another jurisdiction specified by the issuer.
2. If the issuer is the Crown in right of Canada, the jurisdiction specified by the issuer.
3. If the issuer is the Crown in right of a province in Canada, the province or, if permitted by the law of that province, another jurisdiction specified by the issuer.
4. If the issuer is the Commissioner of a territory in Canada, the territory or, if permitted by the law of that territory, another jurisdiction specified by the issuer.
5. In any other case, the jurisdiction under which the issuer is incorporated or otherwise organized or, if permitted by the law of that jurisdiction, another jurisdiction specified by the issuer.

COMMENT

Source: s. 44(1), (2), (3) and (5) are largely based on UCC Rev 8-110 (a) and (d); s. 44(4) is new.

Comparison with previous law: There are no comparable choice of law provisions in existing Canadian law dealing with the transfer of securities. OBCA s. 60 is a limited form of choice of law rule based on (1962) UCC 8-106. Existing Canadian law dealing with the transfer of securities is located in federal and provincial corporate statutes and the choice of law implications are unclear.

Explanation: This section deals with some of the applicability and choice of law issues concerning the STA. The distinction between the direct and indirect holding systems plays a significant role in determining the governing law. An investor in the direct holding system is registered on the books of the issuer and/or has possession of a security certificate. Accordingly, this section and s. 46 generally provide that location of the certificate or the jurisdiction corresponding to some characteristic of the issuer determine the applicable law. By contrast, an investor in the indirect holding system has a security entitlement, which is a bundle of rights against the securities intermediary with respect to a security, rather than a direct interest in the underlying security. Accordingly, in the rules for the indirect holding system described in s. 45, the location of any certificates that might be held by the intermediary or a higher tier intermediary, or any characteristic of the issuer of the underlying security, do not determine the applicable law.

This provision is intended to be substantively uniform with the corresponding provision of Rev 8-110(a) and (d), although the STA uses a somewhat different approach and significantly different language in order to address Canadian constitutional issues. The primary difference is that the STA defines "valid" as a narrower concept than it is in Rev 8. See s. 2 and Comment. The Rev 8 concept of validity does not distinguish between: 1) whether securities are properly-issued under the applicable corporate law; and 2) whether securities that are not properly-issued under the applicable corporate law are still enforceable because the issuer is estopped from denying their validity. Under Rev 8 and other U.S. law, both those questions fall under state law. In Canada, question #1 may fall under Canadian federal law (e.g. the CBCA or the *Bank Act*), while question #2 is a matter of provincial jurisdiction (property and civil rights in the province). The narrower definition of "valid" in the STA enables s. 44 to precisely address which jurisdiction's law governs question #1 (see s. 44(1)) and which jurisdiction's law governs question #2 (see s. 44(4)).

Subsection (1) specifies which law governs the validity of a security according to the

various types of issuers in the Canadian context (i.e. federal corporations, the federal and provincial Crowns, the Commissioner of a territory, and issuers incorporated or otherwise organized under the law of a province or territory). Subsection (2) provides that the law of the "issuer's jurisdiction", as described in s. 44(5), governs certain transfer issues in the direct holding system. If such provision points to a jurisdiction that has enacted the STA, the substantive rules of the STA would determine the issuer's rights and duties in relation to those transfer issues. Section 44(4) ensures that a single body of law governs the questions addressed in Part 3 of the STA concerning the circumstances in which an issuer can and cannot assert invalidity as a defense against purchasers. See, e.g., sections 57-59 and Comments thereto. Similarly, s. 44(2) (a), (b) and (c) ensure that the issuer will be able to look to a single body of law on the questions addressed in Part 5 of the STA, concerning the issuer's duties and liabilities with respect to registration of transfer.

Section 44(2)(d) applies the law of an issuer's jurisdiction to the question whether an adverse claim can be asserted against a purchaser to whom transfer has been registered, or who has obtained control over an uncertificated security. Although this issue deals with the rights of persons other than the issuer, the law of the issuer's jurisdiction applies because the purchasers to whom the provision applies are those whose protection against adverse claims depends on the fact that their interests have been recorded on the books of the issuer.

The principal policy reflected in the choice of law rules in subsections (1), (2) and (4) is that an issuer and others should be able to look to a single body of law on the matters specified in each subsection, rather than having to look to the law of all of the different jurisdictions in which security holders may reside.

Although the STA choice of law rules are drafted differently from Rev 8 in order to precisely address the Canadian context, no other substantive difference is intended. For example, with an issuer incorporated or otherwise organized under provincial law, the STA and Rev 8 produce the same choice of law results, applying the law of the "issuer's jurisdiction" to each of the three issues described in s. 44(1), (2) and (4). Hypothetically, the STA could apply a different jurisdiction's law to each of those three issues, for example, with a security issued under the CBCA or the *Bank Act*:

a) Canadian federal law governs "validity" under s. 44(1);
b) the provincial or territorial law of the "issuer's jurisdiction" governs the transfer issues under s. 44(2); and
c) a different provincial or territorial law may govern the enforceability/estoppel issues under s. 44(4).

Rarely will different laws apply to the issues described in s. 44(2) and (4)—only where

the issuer specifies as its "issuer's jurisdiction" a jurisdiction other than the province or territory where it has its registered or head office. See the discussion of subsection (3) below.

The choice of law policies reflected in this section do not require that the body of law governing the matters specified in subsection (2) be that of the jurisdiction in which the issuer is incorporated. Thus, subsection (5) provides that the term "issuer's jurisdiction" means the jurisdiction corresponding to a certain characteristic of the issuer, or, if permitted by that law, the law of another jurisdiction selected by the issuer. Subsection (3) provides that issuers organized under the law of Ontario may make such a selection. Again, the substantive effect is generally consistent with Rev 8 and produces the same results with one exception. Where the issuer is the Crown in right of Canada, s. 44(5) provides that the "issuer's jurisdiction" is the jurisdiction specified by the issuer, which effectively permits the issuer to select which jurisdiction's laws will govern the enforceability issues described in s. 44(4). No other type of issuer can do this under the STA and no issuer can do this under Rev 8. This exception reflects the unique position of the Crown in right of Canada and no other substantive difference with Rev 8 is intended.

Although subsection (2) provides that the issuer's rights and duties concerning registration of transfer are governed by the law of the issuer's jurisdiction, other matters related to registration of transfer, such as appointment of a guardian for a registered owner or the existence of agency relationships, might be governed by another jurisdiction's law. For example, this section does not deal with what law governs the appointment of the administrator or executor; that question is determined under generally applicable choice of law rules.

This section reflects the view that, with the exception of the validity of a security, legal questions relating to the transfer of securities, including the rights and duties of the issuer with respect to the registration of transfer, are matters of commercial property-transfer law, not corporate law. The fact that existing Canadian law dealing with the transfer of securities is located in corporate statutes instead of commercial property-transfer legislation is an historical accident and one of the principal objectives of the STA is to clarify the law by removing it from corporate statutes. Accordingly, for issuers incorporated under a federal law of Canada, s. 44(5) effectively designates the province or territory where the issuer's registered or head office is located as the "issuer's jurisdiction". Subsection 19(1) of the CBCA requires that a corporation "shall at all times have a registered office in the province in Canada specified in its articles". The *Bank Act* (s. 28), *Trust and Loan Companies Act* (s. 242), *Cooperative Credit Associations Act* (s. 234), and *Insurance Companies Act* (s. 28) all require "a head office in the place within

Canada specified in its incorporating instrument or by-laws". The law of that jurisdiction governs the matters referred to in s. 44(2) and (4), while the validity of a security is governed by federal law under s. 44(1). This is a departure from existing Ontario law. In the case of a security issued by federally incorporated company, current OBCA s. 60(2) would apply the federal law of Canada (including its choice of law rules) to govern the rights and duties with respect to the registration of transfer of a security of an issuer. The STA, like Rev 8, distinguishes between matters of validity (which pertain to the internal affairs of the issuer and formal requirements for issuance of a security), and matters of registration or adverse claims (which are essentially matters of property-transfer law). In the case of a security issued by a federally incorporated company, therefore, s. 44 points to federal law on matters of validity, and to provincial law on matters of registration, adverse claims, and enforceability/estoppel. In the case of a security issued by the Crown in right of Canada, s. 44 points to federal law (e.g. the *Financial Administration Act*) on matters of validity, and to provincial law on matters of registration, adverse claims, and enforceability/estoppel.

See the Comment to s. 45 for examples of the combined operation of sections 44 and 45.

Definitional cross-references:		
	"adverse claim"	s. 1(1)
	"certificated security"	s. 1(1)
	"control"	s. 3
	"issuer"	s. 1(1)
	"person"	s. 1(1)
	"security"	s. 1(1)
	"uncertificated security"	s. 1(1)
	"validity"	s. 7

Matters governed by law of securities intermediary's jurisdiction

45. (1) The law, other than the conflict of law rules, of the securities intermediary's jurisdiction governs,

(a) acquisition of a security entitlement from the securities intermediary;

(b) the rights and duties of the securities intermediary and entitlement holder arising out of a security entitlement;

(c) whether the securities intermediary owes any duty to a person who has an adverse claim to a security entitlement; and

(d) whether an adverse claim may be asserted against a person who,

(i) acquires a security entitlement from the securities intermediary, or

(ii) purchases a security entitlement, or interest in it, from an entitlement holder.

Definition – securities intermediary's jurisdiction

(2) In this section,

"securities intermediary's jurisdiction" means the jurisdiction determined in accordance with the following rules:

1. If an agreement between a securities intermediary and its entitlement holder governing the securities account expressly provides that a particular jurisdiction is the securities intermediary's jurisdiction for the purposes of the law of that jurisdiction, this Act or any provision of this Act, the jurisdiction expressly provided for is the securities intermediary's jurisdiction.

2. If paragraph 1 does not apply and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

3. If neither paragraph 1 nor 2 applies and an agreement between a securities intermediary and its entitlement holder governing the securities account expressly provides that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

4. If none of the preceding paragraphs applies, the securities intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the entitlement holder's account is located.

5. If none of the preceding paragraphs applies, the securities intermediary's jurisdiction is the jurisdiction in which the chief executive office of the securities intermediary is located.

Same

(3) In determining a securities intermediary's jurisdiction, the following matters are not to be taken into account:

1. The physical location of certificates representing financial assets.
2. If an entitlement holder has a security entitlement with respect to a financial asset, the jurisdiction in which the issuer of the financial asset is incorporated or otherwise organized.
3. The location of facilities for data processing or other record keeping concerning the securities account.

COMMENT

Source: S. 45 (1), (2) and (3) are based on UCC Rev 8-110(b), (e) and (f).

Comparison with previous law: There are no comparable conflict of laws provisions in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-110(b), (e), and (f).

Subsection (2) determines what is a "securities intermediary's jurisdiction". The policy of subsection (1) is to ensure that a securities intermediary and all of its entitlement holders can look to a single, readily-identifiable body of law to determine their rights and duties. Accordingly, subsection (2) sets out a sequential series of tests to facilitate identification of that body of law. Subsection (2) permits specification of the securities intermediary's jurisdiction by agreement. In the absence of such a specification, the law chosen by the parties to govern the securities account determines the securities intermediary's jurisdiction. Because the policy of this section is to enable parties to determine, in advance and with certainty, what law will apply to transactions governed by the STA, the validation of selection of governing law by agreement is not conditioned upon a determination that the jurisdiction whose law is chosen bear a "reasonable relation" to the transaction. That is also true with respect to the similar provisions in s. 44(3) and (5) and the PPSA conflict of law rules. See PPSA s. 7.1. Subsection (2) contains additional

default rules for determining the securities intermediary's jurisdiction, the last resort being the jurisdiction in which the chief executive office of the securities intermediary is located.

Subsection (3) makes explicit a point that is implicit in the STA description of a security entitlement as a bundle of rights against the intermediary with respect to a security or other financial asset, rather than as a direct interest in the underlying security or other financial asset. The governing law for relationships in the indirect holding system is not determined by such matters as the jurisdiction of incorporation of the issuer of the securities held through the intermediary, or the location of any physical certificates held by the intermediary or a higher tier intermediary.

Subsection (1) provides that the law of the securities intermediary's jurisdiction governs the issues concerning the indirect holding system that are dealt with in the STA. Paragraphs (1)(a) and (1)(b) cover the matters dealt with in the STA rules defining the concept of security entitlement and specifying the duties of securities intermediaries. Paragraph (1)(c) provides that the law of the securities intermediary's jurisdiction determines whether the intermediary owes any duties to an adverse claimant. Paragraph (1)(d) provides that the law of the securities intermediary's jurisdiction determines whether adverse claims can be asserted against entitlement holders and others.

The following examples illustrate how a court in a jurisdiction which has enacted the STA would determine the governing law:

Example 1. John Doe, a resident of British Columbia, maintains a securities account with Able & Co. Able is incorporated in Saskatchewan. Its chief executive office is located in Alberta. The office where Doe transacts business with Able is located in New Brunswick. The agreement between Doe and Able specifies that Alberta is the securities intermediary's jurisdiction. Through the account, Doe holds securities of a Nova Scotia corporation, which Able holds through Clearing Agency. The rules of Clearing Agency provide that the rights and duties of Clearing Agency and its participants are governed by Ontario law. Section 44(2) specifies that the rights and duties of the issuer regarding a transfer of the underlying security are governed by Nova Scotia law. Section 45 specifies that a controversy concerning the rights and duties as between Clearing Agency and Able is governed by Ontario law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Alberta law.

Example 2. Same facts as to Doe and Able as in Example 1. Through the account, Doe holds securities of a Senegalese corporation, which Able holds through Clearing Agency. Clearing Agency's operations are located in Belgium, and its rules and

agreements with its participants provide that they are governed by Belgian law. Clearing Agency holds the securities through a custodial account at the Paris branch office of Global Bank, which is organized under English law. The agreement between Clearing Agency and Global Bank provides that it is governed by French law. Section 44(1) and (4) provide that the validity of the underlying security and its enforceability against the issuer are governed by Senegalese law. Section 44(2) specifies that the rights and duties of the issuer regarding a transfer of the underlying security are governed by Senegalese law. Section 45 specifies that a controversy concerning the rights and duties as between Global Bank and Clearing Agency is governed by French law, that a controversy concerning the rights and duties as between Clearing Agency and Able is governed by Belgian law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Alberta law.

To the extent that the STA conflict of law rules do not specify the governing law, general conflict of law rules apply. For example, suppose that in either of the preceding examples, Doe enters into an agreement with Roe, also a resident of British Columbia, in which Doe agrees to transfer all of his interests in the securities held through Able to Roe. The STA does not deal with whether such an agreement is enforceable or whether it gives Roe some interest in Doe's security entitlement. The STA specifies what jurisdiction's law governs the issues that are dealt with in the STA. The STA does, however, specify that securities intermediaries have only limited duties with respect to adverse claims. See s. 54. Section 45(1)(c) provides that Alberta law governs whether Able owes any duties to an adverse claimant. Thus, Alberta's STA s. 54 determines whether Roe has any rights against Able.

Definitional cross-references:		
	"adverse claim"	s. 1(1)
	"entitlement holder"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"issuer"	s. 1(1)
	"person"	s. 1(1)
	"securities intermediary"	s. 1(1)
	"security entitlement"	s. 1(1)
	"uncertificated security"	s. 1(1)

Adverse claim governed by law of jurisdiction of security certificate

46. The law, other than the conflict of law rules, of the jurisdiction in which a security certificate is located at the time of delivery governs whether an adverse claim may be asserted against a person to whom the security certificate is delivered.

COMMENT

Source: UCC Rev 8-110(c)

Comparison with previous law: There are no comparable conflict of law provisions in existing Canadian law dealing with the transfer of securities

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-110(c).

Section 46 provides a choice of law rule for adverse claim issues that may arise in connection with delivery of security certificates in the direct holding system. It applies the law of the place of delivery. If a certificated security issued by an Alberta corporation is sold, and the sale is settled by physical delivery of the certificate from Seller to Buyer in Ontario, under section 46, Ontario law determines whether Buyer takes free from adverse claims. The domicile of Seller, Buyer, and any adverse claimant is irrelevant.

Definitional cross-references:		
	"adverse claim"	s. 1(1)
	"delivery"	s. 1(1) and s. 68
	"person"	s. 1(1)
	"security certificate"	s. 1(1)

Seizure

Seizure governed by laws re civil enforcement of judgments

47. Subject to any necessary modifications for the purposes of permitting the operation of sections 48 to 51, the laws governing the civil enforcement of judgments apply to seizures described in those sections.

COMMENT

Source: New

Comparison with previous law: See ABCA s. 73.

Explanation: This provision describes the limited role of sections 48-51. Those sections

enable securities market participants to clearly know the particular methods by which property interests can be seized by a judgment creditor. Comparable provisions appear in the 1909 *Uniform Stock Transfer Act* and subsequent U.S. and Canadian securities transfer legislation. The methods of seizure are the only point governed by these provisions—all other civil enforcement issues are governed by other law.

Sections 48-51 are intended to be substantively uniform with corresponding provisions in Rev 8-112(a) – (d). The STA does not contain a provision similar to Rev 8-112(e) but no substantive difference is intended. That provision is unnecessary because it re-states existing law: that a creditor is entitled to pursue any legal proceedings to assist in effecting seizure by the prescribed methods or in satisfying the claim by other means.

Definitional cross-references: None

Seizure of interest in certificated security

48. (1) Except as otherwise provided in subsection (2) and in section 51, the interest of a judgment debtor in a certificated security may be seized only by actual seizure of the security certificate by a sheriff.

Same

(2) A certificated security for which the security certificate has been surrendered to the issuer may be seized by a sheriff serving a notice of seizure on the issuer at the issuer's chief executive office.

COMMENT

Source: UCC Rev 8-112(a)

Comparison with previous law: See OBCA s. 82; ABCA s. 73; CBCA s. 74; all of which are based on, and similar to, (1962) UCC 8-317, which is similar to s. 13 of the 1909 *Uniform Stock Transfer Act*. This provision has been relocated. In previous law, there was only this one provision dealing with seizure of certificated securities within the direct holding system. Now that there are parallel provisions dealing with seizure of uncertificated securities and security entitlements, all these provisions have been grouped together in Part 2 - General Matters Concerning Securities and Financial Assets.

Explanation: This provision is intended to be substantively uniform with the

corresponding provision of Rev 8-112(a).

In dealing with certificated securities the instrument itself is the vital thing, and therefore a valid seizure cannot be made unless all possibility of the certificate's wrongfully finding its way into a transferee's hands has been removed. This can be accomplished only when the certificate is in the possession of an enforcement officer, the issuer, or an independent third party. In the U.S., a debtor who has been enjoined can still transfer the security in contempt of court. See *Overlock v. Jerome-Portland Copper Mining Co.*, 29 Ariz. 560, 243 P. 400 (1926). We are not aware of any Canadian decisions on this point but the same result seems likely. Therefore, although injunctive or other relief may be available to creditors seeking to gain control of the certificated security, the security certificate itself must be reached to constitute a proper seizure whenever the judgment debtor has possession.

Exceptional enforcement provisions may be provided by complementary local law (e.g. s. 57 and s. 60 of the Alberta *Civil Enforcement Act* and s. 47 of the ABCA provide an exception to this rule for a security issued by an "Alberta private company").

Definitional cross-references:	"certificated security"	s. 1(1)
	"issuer"	s. 1(1)
	"security certificate"	s. 1(1)

Seizure of interest in uncertificated security

49. Except as otherwise provided in section 51, the interest of a judgment debtor in an uncertificated security may be seized only by a sheriff serving a notice of seizure on the issuer at the issuer's chief executive office.

COMMENT

Source: UCC Rev 8-112(b)

Comparison with previous law: There are no provisions in existing Canadian securities transfer legislation dealing with the seizure of an uncertificated security.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-112(b).

Section 49 provides that when the security is uncertificated and registered in the debtor's name, the debtor's interest can be reached only by serving a notice of seizure upon the issuer. The most logical place to serve the issuer would be the place where the transfer records are maintained, but that location might be difficult to identify, especially when the separate elements of a computer network might be situated in different places. The chief executive office is designated as the appropriate place.

Definitional cross-references:		
	"issuer"	s. 1(1)
	"uncertificated security"	s. 1(1)

Seizure of interest in security entitlement

50. Except as otherwise provided in section 51, the interest of a judgment debtor in a security entitlement may be seized only by a sheriff serving a notice of seizure on the securities intermediary with whom the judgment debtor's securities account is maintained.

COMMENT

Source: UCC Rev 8-112(c)

Comparison with previous law: There are no comparable provisions in existing Canadian securities transfer legislation dealing with the seizure of securities held in the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-112(c).

Section 50 provides that a security entitlement can be reached only by serving a notice of seizure on the debtor's securities intermediary. Process is effective only if directed to the debtor's own securities intermediary. If Debtor holds securities through Broker, and Broker in turn holds through Clearing Agency, Debtor's property interest is a security entitlement against Broker. Accordingly, Debtor's creditor cannot seize Debtor's interest by serving a notice of seizure on the Clearing Agency. See also s. 54.

Definitional cross-references:		
	"securities account"	s. 1(1)
	"securities intermediary"	s. 1(1)
	"security entitlement"	s. 1(1)

Notice of seizure to secured party

51. The interest of a judgment debtor in any of the following may be seized by a sheriff serving a notice of seizure on the secured party:

1. A certificated security for which the security certificate is in the possession of a secured party.
2. An uncertificated security registered in the name of a secured party.
3. A security entitlement maintained in the name of a secured party.

COMMENT

Source: UCC Rev 8-112(d)

Comparison with previous law: There are no provisions in existing Canadian securities transfer legislation dealing with the seizure of a security or a security entitlement held by a secured party.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-112(d).

Section 51 provides that when a certificated security, an uncertificated security, or a security entitlement is controlled by a secured party, the debtor's interest can be reached by serving a notice of seizure on the secured party. This section does not attempt to provide for rights as between the creditor and the secured party, as, for example, whether or when the secured party must liquidate the security.

Definitional cross-references:		
	"certificated security"	s. 1(1)
	"secured party"	s. 1(1)
	"security entitlement"	s. 1(1)
	"uncertificated security"	s. 1(1)

Enforceability of contracts

52. A contract or modification of a contract for the sale or purchase of a security is enforceable whether or not there is some writing signed or record authenticated by a person against whom enforcement is sought.

COMMENT

Source: UCC Rev 8-113

Comparison with previous law: See OBCA s. 84, which is based on, and similar to, (1962) UCC 8-319. There are no comparable provisions in the ABCA or CBCA.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-113.

This section provides that the statute of frauds does not apply to contracts for the sale of securities, reversing prior law which had a special statute of frauds in OBCA s. 84. With the increasing use of electronic means of communication, the statute of frauds is unsuited to the realities of the securities business. For securities transactions, whatever benefits a statute of frauds may play in filtering out fraudulent claims are outweighed by the obstacles it places in the development of modern commercial practices in the securities business.

Definitional cross-references:	"purchase"	s. 1(1)
	"security"	s. 1(1)

Rules of evidence re certificated security

53. (1) The evidentiary rules set out in this section apply to a legal proceeding on a certificated security against the issuer of that security.

Admission of signatures

(2) Unless specifically denied in the pleadings, each signature on a security certificate or in a necessary endorsement is admitted.

Same

(3) A signature on a security certificate is presumed to be genuine and authorized but, if the effectiveness of the signature is put in issue, the burden of establishing that it is genuine and authorized is on the party claiming under the signature.

Recovery on certificate

(4) If signatures on a security certificate are admitted or established, the production of the security certificate entitles a holder to recover on the security certificate unless the defendant establishes a defence or defect that goes to the validity of the security.

Establishing that defence or defect cannot be asserted

(5) If it is shown that a defence or defect that goes to the validity of the security exists, the plaintiff has the burden of establishing that the defence or defect cannot be asserted against,

(a) the plaintiff; or

(b) a person under whom the plaintiff claims.

Definitions

(6) In this section,

"defendant" includes respondent; ("défendeur")

"plaintiff" means a person attempting to recover on a security certificate in a legal proceeding, whether described in that proceeding as a plaintiff, appellant, claimant, petitioner, applicant or any other term. ("demandeur")

COMMENT

Source: UCC Rev 8-114

Comparison with previous law: See OBCA s. 59; ABCA s. 52; CBCA s. 53; all of which are based on, and similar to (1962) UCC 8-105(2).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-114.

This section adapts the rules of negotiable instruments law concerning procedure in actions on instruments to legal proceedings on certificated securities governed by the STA. A "legal proceeding on a security" includes any action or proceeding brought against the issuer to enforce a right or interest that is part of the security, such as an action to collect principal or interest or a dividend, or to establish a right to vote or to receive a new security under an exchange offer or plan of reorganization. This section applies only to certificated securities; actions on uncertificated securities are governed by general evidentiary principles.

Signatures on a certificated security are presumed to be enforceable. For example, if an issuer alleges that a signature has been forged, subsection (2) requires the issuer to raise this specifically in the pleadings. Subsection (3) then requires the issuer to introduce enough evidence to rebut the presumption (i.e. enough evidence to support a finding of forgery). If the issuer does that, then the holder claiming on the security has the burden of establishing that the signature is effective (e.g. under s. 57). Strictly speaking, the burden of proving that a signature is genuine is always on the person claiming under the signature, but the presumption in subsection (3) places the initial evidential burden on the person claiming that the signature is forged. If the issuer pleads forgery but presents no evidence on that point, the presumption will apply. If the issuer rebuts the presumption, then the question of forgery is decided on the basis of all the relevant evidence, with the burden of proof on the person claiming under the signature. The presumption and the shifting evidentiary burden are based on the fact that forged or unauthorized signatures are rare and the pertinent evidence is normally controlled by, or most accessible to, the issuer. Once the issuer has introduced sufficient evidence to permit a finding in its favor, the presumption is rebutted and the burden of establishing the signature falls ultimately upon the holder. If signatures are admitted or established, then under subsection (4) the issuer has the burden of establishing a defence or defect going to validity. If the issuer does that, then under subsection (5) the holder claiming on the security has the burden of establishing that the defence or defect cannot be asserted (e.g. if the holder is a purchaser for value without notice described in s. 57).

Definitional cross-references:		
	"certificated security"	s. 1(1)
	"endorsement"	s. 1(1)
	"issuer"	s. 1(1)
	"person"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)

Securities intermediary's liability to adverse claimant

54. (1) Subject to subsection (3), a securities intermediary that has transferred a financial asset in accordance with an effective entitlement order is not liable to a person having an adverse claim to, or a security interest in, the financial asset.

Same

(2) Subject to subsection (3), a broker or other agent or bailee who has dealt with a financial asset at the direction of a customer or principal is not liable to a person having an adverse claim to, or a security interest in, the financial asset.

Same

(3) A securities intermediary referred to in subsection (1) or a broker or other agent or bailee referred to in subsection (2) is liable to a person having an adverse claim to, or a security interest in, the financial asset if the securities intermediary, broker or other agent or bailee, as the case may be, did one or more of the following:

1. Took the action described in subsection (1) or (2) after having been served with an injunction, restraining order or other legal process issued by a court of competent jurisdiction enjoining the securities intermediary, broker or other agent or bailee, as the case may be, from doing so and after having had a reasonable opportunity to obey or otherwise abide by the injunction, restraining order or other legal process.
2. Acted in collusion with the wrongdoer in violating the rights of the person who has the adverse claim or the person who has the security interest.
3. In the case of a security certificate that has been stolen, acted with notice of the adverse claim.

COMMENT

Source: UCC Rev 8-115

Comparison with previous law: See OBCA s. 83; ABCA s. 74; CBCA s. 75; all of which are based on, and similar to (1962) UCC 8-318. This provision has been relocated. In previous law, it applied only to protect an innocent agent or bailee from liability for a transfer within the direct holding system, so it was located together with other direct transfer rules. The provision now extends to intermediaries who perform a comparable role within the indirect holding system, so it has been relocated to Part 2 - General Matters Concerning Securities and Financial Assets.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-115.

The application of this provision to security interests is slightly different in Canada than under the UCC because the PPSA continues to include cut-off rules that are not included in UCC Rev9. See the Comment to the definition of "adverse claim" in s. 1(1). The PPSA cut-off rules may result in certain security interests not meeting the definition of "adverse claim", so this provision refers specifically to protection against security interests where UCC Rev 8-115 refers only to protection against adverse claims. No substantive or policy difference is intended.

1. Other provisions of the STA protect certain purchasers against adverse claims, both for the direct holding system and the indirect holding system. See s. 70 and s. 96. This section deals with the related question of the possible liability of a person who acted as the "conduit" for a securities transaction. It covers both securities intermediaries—the "conduits" in the indirect holding system—and brokers or other agents or bailees—the "conduits" in the direct holding system. The following examples illustrate its operation"

Example 1. John Doe is a customer of the brokerage firm of Able & Co. Doe delivers to Able a certificate for 100 shares of XYZ Co. common stock, registered in Doe's name and properly endorsed, and asks the firm to sell it for him. Able does so. Later, John Doe's spouse Mary Doe brings an action against Able asserting that Able's action was wrongful against her because the XYZ Co. stock was matrimonial property in which she had an interest, and John Doe was acting wrongfully against her in transferring the securities.

Example 2. Mary Roe is a customer of the brokerage firm of Baker & Co. and holds her

securities through a securities account with Baker. Roe instructs Baker to sell 100 shares of XYZ Co. common stock that she carried in her account. Baker does so. Later, Mary Roe's spouse John Roe brings an action against Baker asserting that Baker's action was wrongful against him because the XYZ Co. stock was matrimonial property in which he had an interest, and Mary Roe was acting wrongfully against him in transferring the securities.

Under common law conversion principles, Mary Doe might be able to assert that Able & Co. is liable to her in Example 1 for exercising dominion over property inconsistent with her rights in it. On that or some similar theory John Roe might assert that Baker is liable to him in Example 2. Section 54 protects both Able and Baker from liability.

2. The policy of this section is similar to that of many other rules of law that protect agents and bailees from liability as innocent converters. If a thief steals property and ships it by mail, express service, or carrier, to another person, the recipient of the property does not obtain good title, even though the recipient may have given value to the thief and had no notice or knowledge that the property was stolen. Accordingly, the true owner can recover the property from the recipient or obtain damages in a conversion or similar action. An action against the postal service, express company, or carrier presents entirely different policy considerations. Accordingly, general tort law protects agents or bailees who act on the instructions of their principals or bailors.

3. Except as provided in subsection (3), this section applies even though the securities intermediary, or the broker or other agent or bailee, had notice or knowledge that another person asserts a claim to the securities. Consider the following examples:

Example 3. Same facts as in Example 1, except that before John Doe brought the XYZ Co. security certificate to Able for sale, Mary Doe telephoned or wrote to the firm asserting that she had an interest in all of John Doe's securities and demanding that they not trade for him.

Example 4. Same facts as in Example 2, except that before Mary Roe gave an entitlement order to Baker to sell the XYZ Co. securities from her account, John Roe telephoned or wrote to the firm asserting that he had an interest in all of Mary Roe's securities and demanding that they not trade for her.

Section 54 protects Able and Baker from liability. The protections of s. 54 do not depend on the presence or absence of notice of adverse claims. It is essential to the securities settlement system that brokers and securities intermediaries be able to act promptly on the directions of their customers. Even though a firm has notice that someone asserts a

claim to a customer's securities or security entitlements, the firm should not be placed in the position of having to make a legal judgment about the validity of the claim at the risk of liability either to its customer or to the third party for guessing wrong. Under this section, the broker or securities intermediary is privileged to act on the instructions of its customer or entitlement holder, unless it has been served with a restraining order or other legal process enjoining it from doing so.

Paragraph 1 of subsection (3) of this section refers only to a court order enjoining the securities intermediary or the broker or other agent or bailee from acting at the instructions of the customer. It does not apply to cases where the adverse claimant tells the intermediary or broker that the customer has been enjoined, or shows the intermediary or broker a copy of a court order binding the customer.

Paragraph 3 of subsection (3) takes a different approach in one limited class of cases, those where a customer sells stolen certificated securities through a securities firm. Here the policies that lead to protection of securities firms against assertions of other sorts of claims must be weighed against the desirability of having securities firms guard against the disposition of stolen securities. Accordingly, paragraph (3)3. denies protection to a broker, custodian, or other agent or bailee who receives a stolen security certificate from its customer, if the broker, custodian, or other agent or bailee had notice of adverse claims. The circumstances that give notice of adverse claims are specified in sections 18-22. The result is that brokers, custodians, and other agents and bailees face the same liability for selling stolen certificated securities that purchasers face for buying them.

4. As applied to securities intermediaries, this section embodies one of the fundamental principles of the STA indirect holding system rules—that a securities intermediary owes duties only to its own entitlement holders. The following examples illustrate the operation of this section in the multi-tiered indirect holding system:

Example 5. Able & Co., a broker-dealer, holds 50,000 shares of XYZ Co. stock in its account at Clearing Agency. Able acquired the XYZ shares from another firm, Baker & Co., in a transaction that Baker contends was tainted by fraud, giving Baker a right to rescind the transaction and recover the XYZ shares from Able. Baker sends notice to Clearing Agency stating that Baker has a claim to the 50,000 shares of XYZ Co. in Able's account. Able then initiates an entitlement order directing Clearing Agency to transfer the 50,000 shares of XYZ Co. to another firm in settlement of a trade. Under s. 54, Clearing Agency is privileged to comply with Able's entitlement order, without fear of liability to Baker. This is so even though Clearing Agency has notice of Baker's claim, unless Baker obtains a court order enjoining Clearing Agency from acting on Able's

entitlement order.

Example 6. Able & Co., a broker-dealer, holds 50,000 shares of XYZ Co. stock in its account at Clearing Agency. Able initiates an entitlement order directing Clearing Agency to transfer the 50,000 shares of XYZ Co. to another firm in settlement of a trade. That trade was made by Able for its own account, and the proceeds were devoted to its own use. Able becomes insolvent, and it is discovered that Able has a shortfall in the shares of XYZ Co. stock that it should have been carrying for its customers. Able's customers bring an action against Clearing Agency asserting that Clearing Agency acted wrongfully in transferring the XYZ shares on Able's order because those were shares that should have been held by Able for its customers. Under s. 54, Clearing Agency is not liable to Able's customers, because Clearing Agency acted on an effective entitlement order of its own entitlement holder, Able. Clearing Agency's protection against liability does not depend on the presence or absence of notice or knowledge of the claim by Clearing Agency.

5. If the conduct of a securities intermediary or a broker or other agent or bailee rises to a level of complicity in the wrongdoing of its customer or principal, the policies that favour protection against liability do not apply. Accordingly, paragraph clause (3)2. provides that the protections of this section do not apply if the securities intermediary or broker or other agent or bailee acted in collusion with the customer or principal in violating the rights of another person. The collusion test is intended to adopt a standard akin to the tort rules that determine whether a person is liable as an aider or abettor for the tortious conduct of a third party. See the definition of "in collusion" in s. 1(1) and Comment.

Knowledge that the action of the customer is wrongful is a necessary but not sufficient condition of the collusion test. The aspect of the role of securities intermediaries and brokers that the STA deals with is the clerical or ministerial role of implementing and recording the securities transactions that their customers conduct. Faithful performance of this role consists of following the instructions of the customer. It is not the role of the record-keeper to police whether the transactions recorded are appropriate, so mere awareness that the customer may be acting wrongfully does not itself constitute collusion. That, of course, does not insulate an intermediary or broker from responsibility in egregious cases where its action goes beyond the ordinary standards of the business of implementing and recording transactions, and reaches a level of affirmative misconduct in assisting the customer in the commission of a wrong.

Definitional cross-references:	"broker"	s. 1(1)
	"effective"	s. 1(1) and sections 29-32

"entitlement order"	s. 1(1)
"financial asset"	s. 1(1) and s. 1(2)
"in collusion"	s. 1(1)
"securities intermediary"	s. 1(1)
"security certificate"	s. 1(1)

Securities intermediary as purchaser for value

55. (1) A securities intermediary that receives a financial asset and establishes a security entitlement to the financial asset in favour of an entitlement holder is a purchaser for value of the financial asset.

Same

(2) A securities intermediary that acquires a security entitlement to a financial asset from another securities intermediary acquires the security entitlement for value if the securities intermediary acquiring the security entitlement establishes a security entitlement to the financial asset in favour of an entitlement holder.

COMMENT

Source: UCC Rev 8-116

Comparison with previous law: There are no comparable provisions in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-116.

1. This section is intended to make explicit two points that, while implicit in other provisions, are of sufficient importance to the operation of the indirect holding system that they warrant explicit statement. First, it makes clear that a securities intermediary that receives a financial asset and establishes a security entitlement in respect thereof in favour of an entitlement holder is a "purchaser" of the financial asset that the securities intermediary received. Second, it makes clear that by establishing a security entitlement in favour of an entitlement holder a securities intermediary gives value for any corresponding financial asset that the securities intermediary receives or acquires from another party, whether the intermediary holds directly or indirectly.

In many cases a securities intermediary that receives a financial asset will also be transferring value to the person from whom the financial asset was received. That, however, is not always the case. Payment may occur through a different system than settlement of the securities side of the transaction, or the securities might be transferred without a corresponding payment, as when a person moves an account from one securities intermediary to another. Even though the securities intermediary does not give value to the transferor, it does give value by incurring obligations to its own entitlement holder. Although the general definition of value in s. 1(1) should be interpreted to cover the point, this section is included to make this point explicit.

2. The following examples illustrate the effect of this section:

Example 1. Buyer buys 1000 shares of XYZ Co. common stock through Buyer's broker Able & Co. to be held in Buyer's securities account. In settlement of the trade, the selling broker delivers to Able a security certificate in street name, endorsed in blank, for 1000 shares XYZ Co. stock, which Able holds in its vault. Able credits Buyer's account for securities in that amount. Section 55 specifies that Able is a purchaser of the XYZ Co. stock certificate, and gave value for it. Thus, Able can obtain the benefit of s. 70, which protects purchasers for value, if it satisfies the other requirements of that section.

Example 2. Buyer buys 1000 shares XYZ Co. common stock through Buyer's broker Able & Co. to be held in Buyer's securities account. The trade is settled by crediting 1000 shares XYZ Co. stock to Able's account at Clearing Agency. Able credits Buyer's account for securities in that amount. When Clearing Agency credits Able's account, Able acquires a security entitlement under s. 95. Section 55 specifies that Able acquired this security entitlement for value. Thus, Able can obtain the benefit of s. 96, which protects persons who acquire security entitlements for value, if it satisfies the other requirements of that section.

Example 3. Thief steals a certificated bearer bond from Owner. Thief sends the certificate to his broker Able & Co. to be held in his securities account, and Able credits Thief's account for the bond. Section 55 specifies that Able is a purchaser of the bond and gave value for it. Thus, Able can obtain the benefit of s. 70, which protects purchasers for value, if it satisfies the other requirements of that section.

Definitional cross-references:		
	"entitlement holder"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"purchaser"	s. 1(1)
	"securities intermediary"	s. 1(1)

"security entitlement"	s. 1(1)
"value"	s. 1(1)

Part III
Issue And Issuer

Terms of a security
Certificated security

56. (1) Even against a purchaser for value and without notice, the terms of a certificated security include,

(a) the terms stated on the security certificate; and

(b) any terms made part of the security by reference on the security certificate to another instrument, indenture or other document or to a statute, regulation, rule, order or the like, to the extent that those terms do not conflict with the terms stated on the security certificate.

Same

(2) A reference described in clause (1) (b) does not by itself constitute notice to a purchaser for value of a defect that goes to the validity of the security, even if the security certificate expressly states that a person accepting it admits notice.

Uncertificated security

(3) The terms of an uncertificated security include those stated in any instrument, indenture or other document or in a statute, regulation, rule, order or the like under which the security is issued.

COMMENT

Source: UCC Rev 8-202(a)

Comparison with previous law: See OBCA s. 63(1); ABCA s. 54(1); CBCA s. 55(1); all of which are based on, and similar to (1962) UCC 8-202(1).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-202(a).

In the STA the rights of the purchaser for value without notice are divided into two aspects, those against the issuer, and those against other claimants to the security. Part 3 of the STA, and especially sections 56-60, deal with rights against the issuer.

Section 56 states, in accordance with the prevailing case law, the right of the issuer (who prepares the text of the security) to include terms incorporated by adequate reference to an extrinsic source, so long as the terms so incorporated do not conflict with the stated terms. Thus, the standard practice of referring in a bond or debenture to the trust indenture under which it is issued without spelling out its necessarily complex and lengthy provisions is approved. Every stock certificate refers in some manner to the charter or articles of incorporation of the issuer. A private company's certificates should refer to a unanimous shareholder agreement, if there is one. At least where there is more than one class of stock authorized, corporate statutes normally require a statement or summary as to preferences, voting powers and the like. References to statutes, ordinances, rules, regulations or orders are not so common, except in the obligations of governments (e.g. the *Financial Administration Act)* or governmental agencies or units; but where appropriate they fit into the rule here stated. Rev 8-202 (a) includes the term "constitution" before "statute, ordinance, rule…", while the STA does not because that term has different connotations in Canada and its use adds nothing to this provision in the Canadian context.

Courts have generally held that an issuer is estopped from denying representations made in the text of a security. *Delaware-New Jersey Ferry Co. v. Leeds*, 21 Del.Ch. 279, 186 A. 913 (1936). Nor is a defect in form or the invalidity of a security normally available to the issuer as a defense. *Bonini v. Family Theatre Corporation*, 327 Pa. 273, 194 A. 498 (1937); *First National Bank of Fairbanks v. Alaska Airmotive*, 119 F.2d 267 (C.C.A.Alaska 1941). There are no equivalent Canadian decisions. The STA is intended to produce the same commercial-law results reflected by the U.S. decisions.

The rule in subsection (1) requiring that the terms of a security be noted or referred to on the certificate is based on practices and expectations in the direct holding system for certificated securities. This rule does not express a general rule or policy that the terms of a security are effective only if they are communicated to beneficial owners in some particular fashion. Rather, subsection (1) is based on the principle that a purchaser who

does obtain a certificate is entitled to assume that the terms of the security have been noted or referred to on the certificate. That policy does not come into play in a securities holding system in which purchasers do not take delivery of certificates.

The provisions of subsection (1) concerning notation of terms on security certificates are necessary only because paper certificates play such an important role for certificated securities that a purchaser should be protected against assertion of any defenses or rights that are not noted on the certificate. No similar problem exists with respect to uncertificated securities. Subsection (3) is, strictly speaking, unnecessary, since it only recognizes the fact that the terms of an uncertificated security are determined by whatever other law or agreement governs the security. It is included only to preclude any inference that uncertificated securities are subject to any requirement analogous to the requirement of notation of terms on security certificates.

The rule of subsection (1) applies to the indirect holding system only in the sense that if a certificated security has been delivered to the Clearing Agency or other securities intermediary, the terms of the security should be noted or referred to on the certificate. If the security is uncertificated, that principle does not apply even at the issuer-Clearing Agency level. The beneficial owners who hold securities through the Clearing Agency are bound by the terms of the security, even though they do not actually see the certificate. Since entitlement holders in an indirect holding system have not taken delivery of certificates, the policy of subsection (1) does not apply.

Subsection (2), together with s. 57, embody the concept that it is the duty of the issuer, not of the purchaser, to make sure that the security complies with the law governing its issue. Subsection (2) makes clear that the issuer cannot, by incorporating a reference to a statute or other document, charge the purchaser with notice of the security's invalidity.

Definitional cross-references:		
	"certificated security"	s. 1(1)
	"notice"	s. 3
	"person"	s. 1(1)
	"purchaser"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)
	"uncertificated security"	s. 1(1)
	"valid"	s. 2
	"value"	s. 1(1) and s. 55

Enforcement of security
Unauthorized signature

57. (1) An unauthorized signature placed on a security certificate before or in the course of issue is ineffective except that the signature is effective in favour of a purchaser for value of the certificated security if the purchaser is without notice of the lack of authority and the signing has been done by,

(a) an authenticating trustee, registrar, transfer agent or other person entrusted by the issuer with the signing of the security certificate or of any similar security certificate or with the immediate preparation for signing of any of those security certificates; or

(b) an employee of the issuer, or of any persons referred to in clause (a), entrusted with responsible handling of the security certificate.

Limitation re unauthorized signature – securities issued by governments

(2) Where an unauthorized signature described in subsection (1) is placed on a security certificate issued by a government or agency of it, the signature is ineffective except that the signature is effective in favour of a purchaser for value of the certificated security if the purchaser is without notice of the lack of authority and the signing has been done by an employee of the issuer entrusted with responsible handling of the security certificate.

Defect going to validity

(3) A security issued with a defect going to its validity is enforceable against the issuer if held by a purchaser for value and without notice of the defect and, in the case of such a security issued by a government or agency of it, if there has been substantial compliance with the legal requirements governing the issue.

COMMENT

Source: S. 57(1) is based on UCC Rev 8-205; s. 57(2) and (3) are based on UCC Rev 8-202(b)

Comparison with previous law: See OBCA s. 63(2); ABCA s. 54(2); CBCA s. 55(2); all of which are based on, and similar to (1962) UCC 8-202(2). See OBCA s. 65; ABCA s. 56; CBCA s. 57; all of which are based on, and similar to (1962) UCC 8-205.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-205 and 8-202(b), except as they apply to a security issued by a government or agency of it.

The problem of forged or unauthorized signatures may arise where an employee of the issuer, transfer agent, or registrar has access to securities which the employee is required to prepare for issue by affixing the corporate seal or by adding a signature necessary for issue. Subsection (1) is based upon the issuer's duty to avoid the negligent entrusting of securities to such persons. Issuers have long been held responsible for signatures placed upon securities by parties whom they have held out to the public as authorized to prepare such securities. See *Fifth Avenue Bank of New York v. The Forty-Second & Grand Street Ferry Railroad Co.*, 137 N.Y. 231, 33 N.E. 378, 19 L.R.A. 331, 33 Am.St.Rep. 712 (1893); *Jarvis v. Manhattan Beach Co.*, 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). The "apparent authority" concept of some of the case-law, however, is here extended and this section expressly rejects the technical distinction, made by courts reluctant to recognize forged signatures, between cases where forgers sign signatures they are authorized to sign under proper circumstances and those in which they sign signatures they are never authorized to sign. *Citizens' & Southern National Bank v. Trust Co. of Georgia*, 50 Ga.App. 681, 179 S.E. 278 (1935). Normally the purchaser is not in a position to determine which signature a forger, entrusted with the preparation of securities, has "apparent authority" to sign. The issuer, on the other hand, can protect itself against such fraud by the careful selection and bonding of agents and employees, or by action over against transfer agents and registrars who in turn may bond their personnel. There are no equivalent Canadian cases. These U.S. decisions are part of the context to previous versions of UCC Article 8, existing Canadian law, and the STA.

The issuer cannot be held liable for the honesty of employees not entrusted, directly or indirectly, with the signing, preparation, or responsible handling of similar securities and whose possible commission of forgery it has no reason to anticipate. The result in such

cases as *Hudson Trust Co. v. American Linseed Co.*, 232 N.Y. 350, 134 N.E. 178 (1922), and *Dollar Savings Fund & Trust Co. v. Pittsburgh Plate Glass Co.*, 213 Pa. 307, 62 A. 916, 5 Ann.Cas. 248 (1906) is here adopted. There are no equivalent Canadian cases. These U.S. decisions are part of the context to previous versions of UCC Article 8, existing Canadian law, and the STA.

This section is not concerned with forged or unauthorized endorsements, but only with unauthorized signatures of issuers, transfer agents, etc., placed upon security certificates during the course of their issue. The protection here stated is available to all purchasers for value without notice and not merely to subsequent purchasers.

Subsection (2) limits the application of subsection (1) to a security issued by a government or agency of it. Subsection (3) gives to a purchaser for value without notice of the defect the right to enforce the security against the issuer despite the presence of a defect that otherwise would render the security invalid. There are two circumstances in which a purchaser does not gain such rights.

First, governmental issuers are distinguished in subsection (3) from other issuers as a matter of public policy, and additional safeguards are imposed before governmental issues are validated. Governmental issuers are estopped from asserting defenses only if there has been substantial compliance with the legal requirements governing the issue. The purpose of the substantial compliance requirement is to make certain that a mere technicality as, e.g., in the manner of publishing election notices, shall not be a ground for depriving an innocent purchaser of rights in the security. The policy is here adopted of such U.S. cases as *Tommie v. City of Gadsden*, 229 Ala. 521, 158 So. 763 (1935), in which minor discrepancies in the form of the election ballot used were overlooked and the bonds were declared valid since there had been substantial compliance with the statute. There are no equivalent Canadian cases. The STA is intended to produce the same commercial property-transfer law result, except that it omits the rule expressed in Rev 8-202(b), under which governmental issuers are also estopped if substantial consideration has been received and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security.

Section 67, regarding overissue, provides the second exception to the rule that an innocent purchase for value takes a valid security despite the presence of a defect that would otherwise give rise to invalidity. See that section and its Comment for further explanation.

Rev 8-202(b)(1) contains a special exception for defects involving a violation of a state constitution. The STA does not include such an exception because that issue does not

arise in Canada.

Definitional cross-references:	"certificated security"	s. 1(1)
	"government "	s. 1(1)
	"issuer"	s. 1(1)
	"notice"	s. 11
	"purchaser"	s. 1(1)
	"issuer"	s. 1(1)
	"notice"	s. 11
	"purchaser"	s. 1(1)
	"security certificate"	s. 1(1)
	"valid"	s. 2
	"value"	s. 1(1) and s. 55

Lack of genuineness of certificated security

58. Except as otherwise provided in subsection 57 (1) or (2), lack of genuineness of a certificated security is a complete defence, even against a purchaser for value and without notice of the lack of genuineness.

COMMENT

Source: UCC Rev 8-202(c)

Comparison with previous law: See OBCA s. 63(3); ABCA s. 54(3); CBCA s. 55(3); all of which are based on, and similar to (1962) UCC 8-202(3).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-202(c). It states that an issuer has a complete defence against a security that is forged or counterfeit, subject to s. 57(1) and (2) (see the discussion in the Comment to s. 57).

Definitional cross-references:	"certificated security"	s. 1(1)
	"genuine"	s. 1(1)
	"notice"	s. 11
	"purchaser"	s. 1(1)
	"value"	s. 1(1) and s. 55

Other defences

59. All other defences of the issuer of a security that are not referred to in sections 56 to 58, including non-delivery and conditional delivery of a security, are ineffective against a purchaser for value who has taken the security without notice of the particular defence.

COMMENT

Source: UCC Rev 8-202(d)

Comparison with previous law: See OBCA s. 63(4); ABCA s. 54(4); CBCA s. 55(4); all of which are based on, and similar to (1962) UCC 8-202(4).

Explanation: This provision is intended to be similar to the corresponding provision of Rev 8-202(d). The difference is that Rev 8-202(d) refers only to a "certificated security", while s. 59 refers to a "security". The inclusion of the word "certificated" in Rev 8 appears to be a minor drafting error since there is no reason to restrict the application of this provision to certificated securities. The New York version of UCC Article 8 also deletes the word "certificated". This provision otherwise reflects a well-established rule and there is no substantive change from existing law.

Definitional cross-references:		
	"certificated security"	s. 1(1)
	"delivery"	s. 1(1) and s. 68
	"issuer"	s. 1(1)
	"purchaser	s. 1(1)
	"notice"	s. 11
	"value"	s. 1(1) and s. 55

Right to cancel contract

60. Nothing in sections 56 to 59 affects the right of a party to a "when, as and if issued" contract or a "when distributed" contract to cancel the contract in the event of a material change in the character of the security that is the subject of the contract or in the plan or arrangement under which the security is to be issued or distributed.

COMMENT

Source: UCC Rev 8-202(e)

Comparison with previous law: See OBCA s. 63(5); which is based on, and similar to (1962) UCC 8-202(5). There is no comparable provision in the ABCA or CBCA.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-202(e).

Section 60 is included to make clear that this section does not affect the presently recognized right of either party to a "when, as and if" or "when distributed" contract to cancel the contract on substantial change.

Definitional cross-references: "security" s. 1(1)

Staleness as notice of defect or defence

61. (1) After an act or event that creates a right to immediate performance of the principal obligation represented by a certificated security or that sets a date on or after which the security is to be presented or surrendered for redemption or exchange, a purchaser is deemed to have notice of any defect in the security's issue or of any defence of the issuer,

(a) if,

(i) the act or event requires that, on presentation or surrender of the security certificate, money be paid, a certificated security be delivered or a transfer of an uncertificated security be registered,

(ii) the money or security is available on the date set for payment or exchange, and

(iii) the purchaser takes delivery of the security more than one year after the date referred to in subclause (ii); or

(b) if,

(i) the act or event is not one to which clause (a) applies, and

(ii) the purchaser takes delivery of the security more than two years after the date on which performance became due or the date set for presentation or surrender.

Exception

(2) Subsection (1) does not apply to a call that has been revoked.

COMMENT

Source: UCC Rev 8-203

Comparison with previous law: See OBCA s. 64; ABCA s. 55; CBCA s. 56; all of which are based on, and similar to (1962) UCC 8-203.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-203.

The problem of matured or called securities is here dealt with in terms of the effect of such events in giving notice of the issuer's defenses and not in terms of "negotiability". The substance of this section applies only to certificated securities because certificates may be transferred to a purchaser by delivery after the security has matured, been called, or become redeemable or exchangeable. It is contemplated that uncertificated securities which have matured or been called will merely be canceled on the books of the issuer and the proceeds sent to the registered owner. Uncertificated securities which have become redeemable or exchangeable, at the option of the owner, may be transferred to a purchaser, but the transfer is effectuated only by registration of transfer, thus necessitating communication with the issuer. If defects or defenses in such securities exist, the issuer will necessarily have the opportunity to bring them to the attention of the purchaser.

The fact that a security certificate is in circulation long after it has been called for redemption or exchange must give rise to the question in a purchaser's mind as to why it has not been surrendered. After the lapse of a reasonable period of time a purchaser can no longer claim "no reason to know" of any defects or irregularities in its issue. Where funds are available for the redemption the security certificate is normally turned in more promptly and a shorter time is set as the 'reasonable period' than is set where funds are not available.

Defaulted certificated securities may be traded on financial markets in the same manner as unmatured and undefaulted instruments and a purchaser might not be placed upon

notice of irregularity by the mere fact of default. An issuer, however, should at some point be placed in a position to determine definitely its liability on an invalid or improper issue, and for this purpose a security under this section becomes 'stale' two years after the default. A different rule applies when the question is notice not of issuer's defenses but of claims of ownership. See sections 18-22 and Comments.

Nothing in this section is designed to extend the life of preferred stocks called for redemption as "shares of stock" beyond the redemption date. After such a call, the security represents only a right to the funds set aside for redemption.

Definitional cross-references:		
	"certificated security"	s. 1(1)
	"delivery"	s. 1(1) and s. 68
	"issuer"	s. 1(1)
	"notice"	s. 11
	"purchaser"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)
	"uncertificated security"	s. 1(1)

Effect of issuer's restriction on transfer

62. A restriction on the transfer of a security imposed by the issuer, even if otherwise lawful, is ineffective against a person without knowledge of the restriction unless,

(a) the security is a certificated security and the restriction is noted conspicuously on the security certificate; or

(b) the security is an uncertificated security and the registered owner has been given a notice of the restriction by a person required to give such notice in order to make the restriction effective.

COMMENT

Source: UCC Rev 8-204

Comparison with previous law: See OBCA s. 56(3); ABCA s. 48(8); CBCA s. 49(8); all of which are based on, and similar to (1962) UCC 8-103 and 8-204, which are similar to s. 15 of the 1909 *Uniform Stock Transfer Act*.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-204.

1. Restrictions on transfer of securities are imposed by issuers in a variety of circumstances and for a variety of purposes, such as to retain control of a private company or to comply with securities regulatory law. Other law determines whether such restrictions are permissible. This section deals only with the consequences of failure to note the restriction on a security certificate.

This section imposes no bar to enforcement of a restriction on transfer against a person who knows of it.

2. A restriction on transfer of a certificated security is ineffective against a person without knowledge of the restriction unless the restriction is noted conspicuously on the certificate. The word "noted" is used to make clear that the restriction need not be set forth in full text. If the words "private company" or "compagnie fermée" appear conspicuously on a certificate, the restriction would be "noted" within the meaning of this section. Refusal by an issuer to register a transfer on the basis of an unnoted restriction would be a violation of the issuer's duty to register under s. 86.

3. The policy of this section is the same as in sections 56-60. A purchaser who takes delivery of a certificated security is entitled to rely on the terms stated on the certificate. That policy obviously does not apply to uncertificated securities. For uncertificated securities, this section requires only that the registered owner has been notified of the restriction. Suppose, for example, that A is the registered owner of an uncertificated security, and that the issuer has given notice to A of a restriction on transfer. A agrees to sell the security to B, in violation of the restriction. A completes a written instruction directing the issuer to register transfer to B, and B pays A for the security at the time A delivers the instruction to B. A does not inform B of the restriction, and B does not otherwise have notice or knowledge of it at the time B pays and receives the instruction. B presents the instruction to the issuer, but the issuer refuses to register the transfer on the grounds that it would violate the restriction. The issuer has complied with this section, because it gave notice to the registered owner A of the restriction. The issuer's refusal to register transfer is not wrongful. B has an action against A for breach of transfer warranty; see s. 34(2)(c). B's mistake was treating an uncertificated security transaction in the fashion appropriate only for a certificated security. The mechanism for transfer of uncertificated securities is registration of transfer on the books of the issuer; handing over an instruction only initiates the process. The purchaser should make arrangements to ensure that the price is not paid until it knows that the issuer has or will

register transfer.

4. In the indirect holding system, investors neither take physical delivery of security certificates nor have uncertificated securities registered in their names. So long as the requirements of this section have been satisfied at the level of the relationship between the issuer and the securities intermediary that is a direct holder, this section does not preclude the issuer from enforcing a restriction on transfer. See s. 56 and Comment.

5. This section deals only with restrictions imposed by the issuer. Restrictions imposed by statute (e.g. under Co-operatives legislation or the *Bank Act*) are not affected. See *Quiner v. Marblehead Social Co.*, 10 Mass. 476 (1813); *Madison Bank v. Price*, 79 Kan. 289, 100 P. 280 (1909); *Healey v. Steele Center Creamery Ass'n*, 115 Minn. 451, 133 N.W. 69 (1911). There are no equivalent Canadian cases. The STA is intended to produce the same result. Nor does it deal with private agreements between stockholders containing restrictive covenants as to the sale of the security. "Unanimous shareholder agreements" are given special status under corporate law. Where the issuer is a party to such an agreement imposing transfer restrictions, the restriction is "imposed by the issuer" for purposes of this section. If the issuer is not a party, the restriction is not "imposed by the issuer".

Definitional cross-references:	"certificated security"	s. 1(1)
	"issuer"	s. 1(1)
	"knowledge"	s. 11
	"notify"	s. 11
	"person"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)
	"uncertificated security"	s. 1(1)

Completion of security certificate

63. (1) If a security certificate contains the signatures necessary to the security's issue or transfer but is incomplete in any other respect,

(a) any person may complete the security certificate by filling in the blanks in accordance with the person's authority; and

(b) even if any of the blanks are incorrectly filled in, the security certificate as completed is enforceable by a purchaser who took the security certificate for value and without notice of the incorrectness.

Same

(2) A complete security certificate that has been improperly altered, even if fraudulently, remains enforceable, but only according to its original terms.

COMMENT

Source: UCC Rev 8-206

Comparison with previous law: See OBCA s. 66; ABCA s. 57; CBCA s. 58; all of which are based on, and similar to (1962) UCC 8-206, which is similar to s. 16 of the 1909 *Uniform Stock Transfer Act*.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-206.

1. The problem of forged or unauthorized signatures necessary for the issue or transfer of a security is not involved here, and a person in possession of a blank certificate is not, by this section, given authority to fill in blanks with such signatures. Completion of blanks left in a transfer instruction is dealt with in s. 77.

2. Blanks left upon issue of a security certificate are the only ones dealt with here, and a purchaser for value without notice is protected. A purchaser is not in a good position to determine whether blanks were completed by the issuer or by some person not authorized to complete them. On the other hand the issuer can protect itself by not placing its signature on the writing until the blanks are completed or, if it does sign before all blanks are completed, by carefully selecting the agents and employees to whom it entrusts the writing after authentication. With respect to a security certificate that is completed by the issuer but later is altered, the issuer has done everything it can to protect the purchaser and thus is not charged with the terms as altered. However, it is charged according to the original terms, since it is not thereby prejudiced. If the completion or alteration is obviously irregular, the purchaser may not qualify as a purchaser who took without notice under this section.

3. Only the purchaser who physically takes the certificate is directly protected. However, a transferee may receive protection indirectly through s. 69(1).

4. The protection granted a purchaser for value without notice under this section is modified to the extent that an overissue may result where an incorrect amount is inserted

into a blank. See s. 67.

Definitional cross-references:		
	"certificated security"	s. 1(1)
	"issuer"	s. 1(1)
	"notice"	s. 11
	"person"	s. 1(1)
	"purchaser"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)
	"value"	s. 1(1) and s. 55

Rights and duties of issuer re registered owners

64. (1) Before due presentation for registration of transfer of a certificated security in registered form or the receipt of an instruction requesting registration of transfer of an uncertificated security, an issuer or indenture trustee may treat the registered owner as the person exclusively entitled,

(a) to vote;

(b) to receive notices;

(c) to receive any interest, dividend or other payments; and

(d) to otherwise exercise all the rights and powers of an owner.

Same

(2) Nothing in this Act affects the liability of the registered owner of a security for a call, assessment or the like.

COMMENT

Source: UCC Rev 8-207

Comparison with previous law: See OBCA s. 67(1); ABCA s. 50(1); CBCA s. 51(1); all of which are based on, and similar to (1962) UCC 8-207, which is similar to s. 3 of the 1909 *Uniform Stock Transfer Act*.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-207.

1. Subsection (1) states the issuer's right to treat the registered owner of a security as

the person entitled to exercise all the rights of an owner. This right of the issuer is limited by the provisions of Part 5 of the STA. Once there has been due presentation for registration of transfer, the issuer has a duty to register ownership in the name of the transferee. See s. 86. Thus its right to treat the old registered owner as exclusively entitled to the rights of ownership must cease.

The issuer may under this section make distributions of money or securities to the registered owners of securities without requiring further proof of ownership, provided that such distributions are distributable to the owners of all securities of the same issue and the terms of the security do not require surrender of a security certificate as a condition of payment or exchange. Any such distribution shall constitute a defense against a claim for the same distribution by a person, even if that person is in possession of the security certificate and is a protected purchaser of the security. These matters are analyzed in detail in Commentary No. 4 of the Permanent Editorial Board for the UCC, dated March 10, 1990.

2. Subsection (1) is permissive and does not require that the issuer deal exclusively with the registered owner. It is free to require proof of ownership before paying out dividends or the like if it chooses to. *Barbato v. Breeze Corporation*, 128 N.J.L. 309, 26 A.2d 53 (1942). There are no equivalent Canadian cases but the intention is the same. In some respects, the current location of this provision in Canadian corporate statutes produced different results than in the U.S. See *Verdun v. Toronto Dominion Bank*, [1996] 3 S.C.R. 550, where s. 93(1) of the *Bank Act*, which is similar to s. 78, prevented a "beneficial shareholder" from advancing a shareholder proposal—a long-standing right under U.S. law. The *Bank Act* was later amended to expressly permit such proposals. The rights of persons who hold through the indirect holding system are also addressed in securities regulatory law (e.g. National Instrument 54-101 — Communication With Beneficial Owners Of Securities Of Reporting Issuers). The rights of an entitlement holder against the securities intermediary include rights to have the intermediary take action to obtain payments or distributions (s. 99) or to exercise rights with respect to the financial asset (s. 100).

3. This section does not operate to determine who is finally entitled to exercise voting and other rights or to receive payments and distributions. The parties are still free to incorporate their own arrangements as to these matters in seller-purchaser agreements which may be definitive as between them.

4. The UCC Comment to Rev 8-207 confirms that no change in existing state laws as to the liability of registered owners for calls and assessments is here intended; nor is anything in this section designed to estop record holders from denying ownership when

assessments are levied if they are otherwise entitled to do so under applicable law. See *State ex rel. Squire v. Murfey, Blosson & Co.*, 131 Ohio St. 289, 2 N.E.2d 866 (1936); *Willing v. Delaplaine*, 23 F.Supp. 579 (1937). There are no equivalent Canadian cases. These U.S. decisions are part of the context to previous versions of UCC Article 8, existing Canadian law, and the STA.

5. No interference is intended with the common practice of closing the transfer books or taking a record date for dividend, voting, and other purposes, as provided for in by-laws, charters, and statutes.

Although most often considered in the context of corporate issuers, this provision applies equally to non-corporate issuers of registered securities, including trusts, partnerships and governments.

Definitional cross-references:		
	"certificated security"	s. 1(1)
	"instruction"	s. 1(1)
	"issuer"	s. 1(1)
	"registered form"	s. 1(1)
	"security"	s. 1(1)
	"uncertificated security"	s. 1(1)

Warranties by person signing security certificate

65. (1) A person signing a security certificate as authenticating trustee, registrar, transfer agent or the like warrants to a purchaser for value of the certificated security, if the purchaser is without notice of a particular defect in respect of that security, that,

(a) the security certificate is genuine;

(b) the person's own participation in the issue of the security is within the person's capacity and within the scope of the authority received by the person from the issuer; and

(c) the person has reasonable grounds to believe that the certificated security is in the form and within the amount the issuer is authorized to issue.

Limitation

(2) Unless otherwise agreed, a person signing a security certificate under subsection (1) does not assume responsibility for the validity of the security in any respect other than that set out in subsection (1).

COMMENT

Source: UCC Rev 8-208

Comparison with previous law: See OBCA s. 68; ABCA s. 58; CBCA s. 59; all of which are based on, and similar to (1962) UCC 8-208.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-208.

This Comment refers to a number of American cases to which there are no equivalent Canadian cases. The U.S. decisions are part of the context to previous versions of UCC Article 8, existing Canadian law, and the STA.

1. The warranties here stated express the current understanding and prevailing case law as to the effect of the signatures of authenticating trustees, transfer agents, and registrars. See *Jarvis v. Manhattan Beach Co.*, 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). Although it has generally been regarded as the particular obligation of the transfer agent to determine whether securities are in proper form as provided by the by-laws and Articles of Incorporation, neither a registrar nor an authenticating trustee should properly place a signature upon a certificate without determining whether it is at least regular on its face. The obligations of these parties in this respect have therefore been made explicit in terms of due care. See *Feldmeier v. Mortgage Securities, Inc.*, 34 Cal.App.2d 201, 93 P.2d 593 (1939).

2. Those cases which hold that an authenticating trustee is not liable for any defect in the mortgage or property which secures the bond or for any fraudulent misrepresentations made by the issuer are not here affected since these matters do not involve the genuineness or proper form of the security. *Ainsa v. Mercantile Trust Co.*, 174 Cal. 504, 163 P. 898 (1917); *Tschetinian v. City Trust Co.*, 186 N.Y. 432, 79 N.E. 401 (1906); *Davidge v. Guardian Trust Co. of New York*, 203 N.Y. 331, 96 N.E. 751 (1911).

3. The charter or an applicable statute may affect the capacity of a bank or other corporation undertaking to act as an authenticating trustee, registrar, or transfer agent. Such corporations are therefore held to certify as to their legal capacity to act as well as to their authority.

4. Authenticating trustees, registrars, and transfer agents have normally been held liable

for an issue in excess of the authorized amount. *Jarvis v. Manhattan Beach Co.*, supra; *Mullen v. Eastern Trust & Banking Co.*, 108 Me. 498, 81 A. 948 (1911). In imposing upon these parties a duty of due care with respect to the amount they are authorized to help issue, this section does not validate the security, but merely holds persons responsible for the excess issue liable in damages for any loss suffered by the purchaser.

5. Aside from questions of genuineness and excess issue, these parties are not held to certify as to the validity of the security unless they specifically undertake to do so. The case law which has recognized a unique responsibility on the transfer agent's part to testify as to the validity of any security which it countersigns is rejected.

6. This provision does not prevent a transfer agent or issuer from agreeing with a registrar of stock to protect the registrar in respect of the genuineness and proper form of a security certificate signed by the issuer or the transfer agent or both. Nor does it interfere with proper indemnity arrangements between the issuer and trustees, transfer agents, registrars, and the like.

7. An unauthorized signature is a signature for purposes of this section if and only if it is made effective by s. 57.

Definitional cross-references:		
	"certificated security"	s. 1(1)
	"genuine"	s. 1(1)
	"issuer"	s. 1(1)
	"notice"	s. 11
	"person"	s. 1(1)
	"purchaser"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)
	"uncertificated security"	s. 1(1)
	"value"	s. 1(1) and s. 55

Issuer's lien

66. A lien in favour of an issuer on a certificated security is valid against a purchaser only if the right of the issuer to the lien is noted conspicuously on the security certificate.

COMMENT

Source: UCC Rev 8-209

Comparison with previous law: See OBCA s. 56(3); ABCA s. 48(8); CBCA s. 49(8); all of which are based on, and similar to (1962) UCC 8-103, which is similar to s. 15 of the 1909 *Uniform Stock Transfer Act*.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-209.

This section is similar to sections 56 and 62 which require that the terms of a certificated security and any restriction on transfer imposed by the issuer be noted on the security certificate. This section differs from those two sections in that the purchaser's knowledge of the issuer's claim is irrelevant. "Noted" makes clear that the text of the lien provisions need not be set forth in full. However, this would not override a provision of an applicable corporation statute requiring a particular form of statement. This section does not apply to uncertificated securities. It applies to the indirect holding system in the same fashion as sections 56 and 62. See the Comment to s. 56.

Definitional cross-references:		
	"certificated security"	s. 1(1)
	"issuer"	s. 1(1)
	"purchaser"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)

Overissue

67. (1) Except as otherwise provided in subsections (2) and (3), the provisions of this Act that make a security enforceable against an issuer despite a defence or defect or that compel a security's issue or reissue do not apply to the extent that the application of such provision would result in an overissue.

Same

(2) If an identical security not constituting an overissue is reasonably available for purchase, a person entitled to issue of a security, or a

person entitled to enforce a security against an issuer despite a defence or defect as provided under section 57, 58 or 59 or under a similar law of another jurisdiction, may compel the issuer to purchase the security and deliver it, if certificated, or register its transfer, if uncertificated, against surrender of any security certificate the person holds.

Same

(3) If an identical security not constituting an overissue is not reasonably available for purchase, a person entitled to issue of a security, or a person entitled to enforce a security against an issuer despite a defence or defect as provided under section 57, 58 or 59 or under a similar law of another jurisdiction, may recover from the issuer the price that the last purchaser for value paid for the security with interest from the date of the person's demand.

Same

(4) An overissue is deemed not to have occurred if appropriate action has cured the overissue.

COMMENT

Source: UCC Rev 8-210

Comparison with previous law: See OBCA s. 58(1); ABCA s. 51(1); CBCA s. 52(1); all of which are based on, and similar to (1962) UCC 8-104.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-210.

See the definition of "overissue" in s. 1(1) and Comment. This Comment refers to a number of American cases to which there are no equivalent Canadian cases. The U.S. decisions are part of the context to previous versions of UCC Article 8, existing Canadian law, and the STA.

Where an identical security is reasonably available for purchase, whether because traded on an organized market, or because one or more security owners may be willing

to sell at a not unreasonable price, the issuer, although unable to issue additional shares, will be able to purchase them and may be compelled to follow that procedure. *West v. Tintic Standard Mining Co.*, 71 Utah 158, 263 P. 490 (1928).

The right to recover damages from an issuer who has permitted an overissue to occur is well settled. *New York and New Haven R.R. Co. v. Schuyler*, 34 N.Y. 30 (1865). The measure of such damages, however, has been open to question, some courts basing them upon the value of stock at the time registration is refused; some upon the value at the time of trial; and some upon the highest value between the time of refusal and the time of trial. *Allen v. South Boston Railroad*, 150 Mass. 200, 22 N.E. 917, 5 L.R.A. 716, 15 Am.St.Rep. 185 (1889); *Commercial Bank v. Kortright*, 22 Wend. (N.Y.) 348 (1839). The purchase price of the security to the last purchaser who gave value for it is here adopted as being the fairest means of reducing the possibility of speculation by the purchaser. Interest may be recovered as the best available measure of compensation for delay.

The overissue provisions might apply in the situation contemplated by existing OBCA s. 56(8) and (10), where an issuer is obligated, but fails to, disclose a transfer restriction. In that situation, the STA provides that the transfer restriction is not enforceable against an innocent purchaser without notice (see s. 62 and s. 86) but, if the issuer is not authorized to register the transfer because it would result in the violation of some constraint, s. 67 provides the appropriate solution.

Definitional cross-references:		
	"certificated security"	s. 1(1)
	"deliver"	s. 1(1) and s. 68
	"issuer"	s. 1(1)
	"overissue"	s. 1(1)
	"purchaser"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)
	"uncertificated security"	s. 1(1)
	"valid"	s. 2
	"value"	s. (1) and s. 55

Part IV
Transfer of Certificated and Uncertificated Securities

Delivery and Rights of Purchaser

Delivery of security
Certificated security

68. (1) Delivery of a certificated security to a purchaser occurs when,

(a) the purchaser acquires possession of the security certificate;

(b) another person, other than a securities intermediary, either,

(i) acquires possession of the security certificate on behalf of the purchaser, or

(ii) having previously acquired possession of the security certificate, acknowledges that the person holds the security certificate for the purchaser; or

(c) a securities intermediary acting on behalf of the purchaser acquires possession of the security certificate, the security certificate is in registered form and the security certificate is,

(i) registered in the name of the purchaser,

(ii) payable to the order of the purchaser, or

(iii) specially endorsed to the purchaser by an effective endorsement and has not been endorsed to the securities intermediary or in blank.

Uncertificated security

(2) Delivery of an uncertificated security to a purchaser occurs when,

(a) the issuer registers the purchaser as the registered owner, on the original issue or the registration of transfer; or

(b) another person, other than a securities intermediary, either,

(i) becomes the registered owner of the uncertificated security on behalf of the purchaser, or

(ii) having previously become the registered owner, acknowledges that the person holds the uncertificated security for the purchaser.

COMMENT

Source: UCC Rev 8-301

Comparison with previous law: See OBCA s. 78(1); ABCA s. 69(1); CBCA s. 70(1); all of which are based on, and similar to (1962) UCC 8-313(1).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-301.

1. This section specifies the requirements for "delivery" of securities. Delivery is used in the STA to describe the formal steps necessary for a purchaser to acquire a direct interest in a security under the STA. The concept of delivery refers to the implementation of a transaction, not the legal categorization of the transaction which is consummated by delivery. Issuance and transfer are different kinds of transactions, though both may be implemented by delivery. Sale and pledge are different kinds of transfers, but both may be implemented by delivery.

2. Subsection (1) defines delivery with respect to certificated securities. Clause (a) of subsection (1) deals with simple cases where purchasers themselves acquire physical possession of certificates. Clauses (b) and (c) of subsection (1) specify the circumstances in which delivery to a purchaser can occur although the certificate is in the possession of a person other than the purchaser. Clause (b) contains the general rule that a purchaser can take delivery through another person, so long as the other person is actually acting on behalf of the purchaser or acknowledges that it is holding on behalf of the purchaser. Clause (b) does not apply to acquisition of possession by a securities intermediary, because a person who holds securities through a securities account acquires a security entitlement, rather than having a direct interest. See s. 95. Clause (1)(c) specifies the limited circumstances in which delivery of security certificates to a securities intermediary is treated as a delivery to the customer. Note that delivery is a method of perfecting a security interest in a certificated security under PPSA s. 22(2) and (3).

3. Subsection (2) defines delivery with respect to uncertificated securities. Use of the term "delivery" with respect to uncertificated securities, does, at least on first hearing,

seem a bit solecistic. The word "delivery" is, however, routinely used in the securities business in a broader sense than manual tradition. For example, settlement by entries on the books of a clearing agency is commonly called "delivery", as in the expression "delivery versus payment". The diction of this section has the advantage of using the same term for uncertificated securities as for certificated securities, for which delivery is conventional usage. Clause (a) of subsection (2) provides that delivery occurs when the purchaser becomes the registered owner of an uncertificated security, either upon original issue or registration of transfer. Paragraph (b) of subsection (2) provides for delivery of an uncertificated security through a third person, in a fashion analogous to clause (1)(b).

Definitional cross-references:

"certificated security"	s. 1(1)
"effective"	sections 29-32
"issuer"	s. 1(1)
"purchaser"	s. 1(1)
"registered form"	s. 1(1)
"securities intermediary"	s. 1(1)
"security certificate"	s. 1(1)
"security interest"	s. 1(1)
"special endorsement"	s. 71(3)
"uncertificated security"	s. 1(1)

Rights of purchaser

69. (1) Except as otherwise provided in subsections (2) and (3), a purchaser of a certificated or uncertificated security acquires all rights in the security that the transferor had or had power to transfer.

Same

(2) A purchaser of a limited interest in a security acquires rights only to the extent of the interest purchased.

Same

(3) A purchaser of a certificated security who as a previous holder had notice of an adverse claim does not improve that purchaser's position by virtue of taking from a protected purchaser.

COMMENT

Source: UCC Rev 8-302

Comparison with previous law: See OBCA s. 69(1) and (3); ABCA s. 59(1) and (3); CBCA s. 60(1) and (3); all of which are based on, and similar to (1962) UCC 8-301(1) and (3).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-302.

1. Subsection (1) provides that a purchaser of a certificated or uncertificated security acquires all rights that the transferor had or had power to transfer. This statement of the familiar "shelter" principle is qualified by the exceptions that a purchaser of a limited interest acquires only that interest, subsection (2), and that a person who does not qualify as a protected purchaser cannot improve its position by taking from a subsequent protected purchaser, subsection (3).

2. Although this section provides that a purchaser acquires a property interest in a certificated or uncertificated security, it does not state that a person can acquire an interest in a security only by purchase. The STA is also not a comprehensive codification of all of the law governing the creation or transfer of interests in securities. For example, the grant of a security interest is a transfer of a property interest, but the formal steps necessary to effectuate such a transfer are governed by the PPSA not by the STA. Under the PPSA rules, a security interest in a certificated or uncertificated security can be created by execution of a security agreement and can be perfected by filing. A transfer of a PPSA security interest can be implemented by a STA delivery, but need not be.

Similarly, the STA does not determine whether a property interest in a certificated or uncertificated security is acquired under other law, such as the law of gifts, trusts, or equitable remedies. Nor does the STA deal with transfers by operation of law. For example, transfers from decedent to administrator, from ward to guardian, and from bankrupt to trustee in bankruptcy are governed by other law as to both the time they occur and the substance of the transfer. The STA rules do, however, determine whether the issuer is obligated to recognize the rights that a third party, such as a transferee, may acquire under other law. See sections 64, 86 and 91.

Definitional cross-references:	"certificated security"	s. 1(1)
	"delivery"	s. 1(1) and s. 68
	"notice of adverse claim"	sections 18-22
	"protected purchaser"	s. 1(1)
	"purchaser"	s. 1(1)
	"security interest"	s. 1(1)
	"uncertificated security"	s. 1(1)

Protected purchaser

70. A protected purchaser, in addition to acquiring the rights of a purchaser, also acquires the purchaser's interest in the security free of any adverse claim.

COMMENT

Source: UCC Rev 8-303

Comparison with previous law: See OBCA s. 69(2); ABCA s. 59(2); CBCA s. 60(2); all of which are based on, and similar to (1962) UCC 8-301(2).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-303.

1. The definition in s. 1(1) lists the requirements that a purchaser must meet to qualify as a "protected purchaser". Section 70 provides that a protected purchaser takes its interest free from adverse claims. "Purchaser" and "purchase" are defined broadly in s. 1(1). A secured party as well as an outright buyer can qualify as a protected purchaser. Also, "purchase" includes taking by issue, so a person to whom a security is originally issued can qualify as a protected purchaser.

2. To qualify as a protected purchaser, a purchaser must give value, take without notice of any adverse claim, and obtain control. Value is used in the broad sense defined in s. 1(1). See also s. 55 (securities intermediary as purchaser for value). Adverse claim is defined in s. 1(1). Sections 18-22 specify whether a purchaser has notice of an adverse claim. Control is defined in s. 1(1) and sections 23-26. To qualify as a protected purchaser there must be a time at which all of the requirements are satisfied. Thus if a purchaser obtains notice of an adverse claim before giving value or satisfying the requirements for control, the purchaser cannot be a protected purchaser. See also s. 74.

The requirement that a protected purchaser obtain control expresses the point that to qualify for the adverse claim cut-off rule a purchaser must take through a transaction that is implemented by the appropriate mechanism. By contrast, the rules in Part 3 provide that any purchaser for value of a security without notice of a defence may take free of the issuer's defence based on that defence. See sections 57-59.

3. The requirements for control differ depending on the form of the security. For securities represented by bearer certificates, a purchaser obtains control by delivery. See s. 23(1) and s. 68(1). For securities represented by certificates in registered form, the requirements for control are: (1) delivery as defined in s. 68(1), plus (2) either an effective endorsement or registration of transfer by the issuer. See s. 23(2). Thus, a person who takes through a forged endorsement does not qualify as a protected purchaser by virtue of the delivery alone. If, however, the purchaser presents the certificate to the issuer for registration of transfer, and the issuer registers transfer over the forged endorsement, the purchaser can qualify as a protected purchaser of the new certificate. If the issuer registers transfer on a forged endorsement, the true owner will be able to recover from the issuer for wrongful registration (see s. 91) unless the owner's delay in notifying the issuer of a loss or theft of the certificate results in preclusion under s. 93.

For uncertificated securities, a purchaser can obtain control either by delivery, see s. 24(1)(a) and s. 68(2), or by obtaining an agreement pursuant to which the issuer agrees to act on instructions from the purchaser without further consent from the registered owner, see s. 24(1)(b). The control agreement device of s. 24(1)(b) can provide a secured lender with an interest similar to the "registered pledge" concept of the 1978 version of UCC Article 8. A secured lender who obtains a control agreement under s. 24(1)(b) can qualify as a protected purchaser of an uncertificated security.

4. This section states directly the rules determining whether one takes free from adverse claims without using the phrase "good faith". Whether a person who takes under suspicious circumstances is disqualified is determined by the rules of sections 18-22 on notice of adverse claims. The term "protected purchaser", which replaces the terms "bona fide purchaser" and "good faith purchaser" used in previous law, is derived from the term "protected holder" used in the Convention on International Bills and Notes prepared by the United Nations Commission on International Trade Law (UNCITRAL).

This section rejects the decision in *First City Trust v. Emery* (1985), 64 B.C.L.R. 326 (B.C.S.C.), to the extent that decision held that a *bona fide* purchaser for value, without notice of an adverse claim, takes securities subject to that adverse claim.

Definitional cross-references:	"adverse claim"	s. 1(1)
	"protected purchaser"	s. 1(1)
	"purchaser"	s. 1(1)
	"secured party"	s. 1(1)

Endorsements and Instructions

Form of endorsement

71. (1) An endorsement may be in blank or special.

Endorsement in blank

(2) An endorsement in blank includes an endorsement to bearer.

Special endorsement

(3) For an endorsement to be a special endorsement, the endorsement must specify to whom the security is to be transferred or who has power to transfer the security.

Conversion from blank to special

(4) A holder may convert an endorsement in blank to a special endorsement.

COMMENT

Source: UCC Rev 8-304(a)

Comparison with previous law: See OBCA s. 73(2); ABCA s. 64(4)-(7); CBCA s. 65(4)-(7); all of which are based on, and similar to (1962) UCC 8-308(2), which is similar to s. 21 of the 1909 *Uniform Stock Transfer Act*.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-304(a).

By virtue of the definition of endorsement in s. 1(1) and the rules of this section, the simplified method of endorsing certificated securities originally described in the *Uniform Stock Transfer Act* is continued. Although more than one special endorsement on a given security certificate is possible, the desire for dividends or interest, as the case may be, should operate to bring the certificate home for registration of transfer within a reasonable period of time. The usual form of assignment which appears on the back of a stock certificate or in a separate "power" may be filled up either in the form of an assignment, a power of attorney to transfer, or both. If it is not filled up at all but merely signed, the endorsement is in blank. If filled up either as an assignment or as a power of attorney to transfer, the endorsement is special.

Definitional cross-references:		
	"endorsement"	s. 1(1)
	"security"	s. 1(1)

Endorsement of part of a security certificate

72. An endorsement of a security certificate, if the endorsement purports to be in respect of only some of the units represented by the certificate, is effective to the extent of the endorsement if the units are intended by the issuer to be separately transferable.

COMMENT

Source: UCC Rev 8-304(b)

Comparison with previous law: See OBCA s. 73(4); ABCA s. 64(9); CBCA s. 65(9); all of which are based on, and similar to (1962) UCC 8-308(5).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-304(b).

Section 72 recognizes the validity of a "partial" endorsement (e.g. as to fifty shares of the one hundred represented by a single certificate). This section does not specify the rights of a transferee under a partial endorsement to the status of a protected purchaser. That issue evidently does not arise in practice as there are no U.S. or Canadian cases addressing it.

Definitional cross-references:		
	"endorsement"	s. 1(1)
	"issuer"	s. 1(1)
	"security certificate"	s. 1(1)

When endorsement constitutes transfer of security

73. An endorsement of a security certificate, whether special or in blank, does not constitute a transfer of the security,

(a) until the delivery of the security certificate on which the endorsement appears; or

(b) if the endorsement is on a separate document, until the delivery of both the security certificate and the document on which the endorsement appears.

COMMENT

Source: UCC Rev 8-304(c)

Comparison with previous law: See OBCA s. 74; ABCA s. 65; CBCA s. 66; all of which are based on, and similar to (1962) UCC 8-309, which is similar to sections 1 and 10 of the 1909 *Uniform Stock Transfer Act*.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-304(c).

Section 73 deals with the effect of an endorsement without delivery. There must be a voluntary parting with control in order to effect a valid transfer of a certificated security as between the parties. *Levey v. Nason*, 279 Mass. 268, 181 N.E. 193 (1932), and *National Surety Co. v. Indemnity Insurance Co. of North America*, 237 App.Div. 485, 261 N.Y.S. 605 (1933). The provision in Section 10 of the *Uniform Stock Transfer Act* that an attempted transfer without delivery amounts to a promise to transfer is omitted. Even under that Act the effect of such a promise was left to the applicable law of contracts, and the STA by making no reference to such situations intends to achieve a similar result. With respect to delivery there is no counterpart to s. 74 on right to compel endorsement, such as is envisaged in *Johnson v. Johnson*, 300 Mass. 24, 13 N.E.2d 788 (1938), where the transferee under a written assignment was given the right to compel a transfer of the certificate. There are no equivalent Canadian cases to the U.S decisions referred to in this Comment. These U.S. decisions are part of the context to previous versions of UCC Article 8, existing Canadian law, and the STA.

Definitional cross-references:	"delivery"	s. 1(1) and s. 68
	"endorsement"	s. 1(1)
	"security certificate"	s. 1(1)

Endorsement missing

74. If a security certificate in registered form has been delivered to a purchaser without a necessary endorsement, the purchaser may become a protected purchaser only when the endorsement is supplied, but against the transferor, the transfer is complete on delivery and the purchaser has a specifically enforceable right to have any necessary endorsement supplied.

COMMENT

Source: UCC Rev 8-304(d)

Comparison with previous law: See OBCA s. 72; ABCA s. 63; CBCA s. 64; all of which are based on, and similar to (1962) UCC 8-307, which is similar to s. 9 of the 1909 *Uniform Stock Transfer Act*.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-304(d).

Section 74 deals with the effect of delivery without endorsement. As between the parties the transfer is made complete upon delivery, but the transferee cannot become a protected purchaser until endorsement is made. The endorsement does not operate retroactively, and notice may intervene between delivery and endorsement so as to prevent the transferee from becoming a protected purchaser. Although a purchaser taking without a necessary endorsement may be subject to claims of ownership, any issuer's defence of which the purchaser had no notice at the time of delivery will usually be cut off, since the provisions of the STA protect most purchasers for value without notice. See sections 57-59.

The transferee's right to compel an endorsement where a security certificate has been delivered with intent to transfer is recognized in the case law. See *Coats v. Guaranty Bank & Trust Co.*, 170 La. 871, 129 So. 513 (1930). A proper endorsement is one of the requisites of transfer which a purchaser of a certificated security has a right to obtain (s. 85). A purchaser may not only compel an endorsement under that section but may also recover for any reasonable expense incurred by the transferor's failure to respond to the

demand for an endorsement. There are no equivalent Canadian cases to the U.S decision referred to in this Comment. That U.S. decision is part of the context to previous versions of UCC Article 8, existing Canadian law, and the STA.

Definitional cross-references:		
	"delivery"	s. 1(1) and s. 68
	"endorsement"	s. 1(1)
	"protected purchaser"	s. 1(1)
	"purchaser"	s. 1(1)
	"registered form"	s. 1(1)
	"security certificate"	s. 1(1)

Notice of adverse claim on endorsement

75. A purported endorsement of a security certificate in bearer form may constitute notice of an adverse claim to the security certificate, but the purported endorsement does not otherwise affect any right that the holder has.

COMMENT

Source: UCC Rev 8-304(e)

Comparison with previous law: See OBCA s. 75; ABCA s. 66; CBCA s. 67; all of which are based on, and similar to (1962) UCC 8-310.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-304(e).

Section 75 deals with the significance of a purported endorsement on a security certificate in bearer form. This provision differs from Rev 8-304(e) only by the addition of the word "purported", which recognizes that the concept and definition of endorsement applies only to registered securities. A purported endorsement of bearer paper is normally of no effect. An endorsement "for collection", "for surrender" or the like, charges a purchaser with notice of adverse claims (s. 21) but does not operate beyond this to interfere with any right the holder may otherwise possess to have the security registered.

Definitional cross-references:		
	"adverse claim"	s. 1(1) and sections 18-22
	"bearer form"	s. 1(1)
	"endorsement"	s. 1(1)
	"security certificate"	s. 1(1)

Obligations of endorser

76. Unless otherwise agreed, a person making an endorsement makes only the warranties set out in sections 33 and 35 and does not warrant that the security will be honoured by the issuer.

COMMENT

Source: UCC Rev 8-304(f)

Comparison with previous law: See OBCA s. 73(3); ABCA s. 64(8); CBCA s. 65(8); all of which are based on, and similar to (1962) UCC 8-308(4).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-304(f).

Section 76 makes clear that the endorser of a security certificate does not warrant that the issuer will honor the underlying obligation. In view of the nature of investment securities and the circumstances under which they are normally transferred, a transferor cannot be held to warrant as to the issuer's actions. As a transferor the endorser, of course, remains liable for breach of the warranties set forth in sections 33 and 35.

Definitional cross-references:	"endorsement"	s. 1(1)
	"issuer"	s. 1(1)
	"security"	s. 1(1)

Completion of instruction

77. If an instruction has been originated by the appropriate person but is incomplete in any other respect, any person may complete the instruction in accordance with the person's authority and the issuer may rely on the instruction as completed, even if it has been completed incorrectly.

COMMENT

Source: UCC Rev 8-305(a)

Comparison with previous law: There is no comparable provision in existing Canadian

law dealing with the transfer of uncertificated securities.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-305(a).

The term instruction is defined in s. 1(1) as a notice communicated to the issuer of an uncertificated security directing that transfer be registered. Sections 29-32 specify who may initiate an effective instruction.

Functionally, presentation of an instruction is quite similar to the presentation of an endorsed certificate for reregistration. Note that instruction is defined in terms of "communicate", which is also defined in s. 1(1). Thus, the instruction may be in the form of a writing signed by the registered owner or in any other form agreed upon by the issuer and the registered owner. Allowing nonwritten forms of instructions will permit the development and employment of means of transmitting instructions electronically.

When a person who originates an instruction leaves a blank and the blank later is completed, this section gives the issuer the same rights it would have had against the originating person had that person completed the blank. This is true regardless of whether the person completing the instruction had authority to complete it. Compare s. 63 and its Comment, dealing with blanks left upon issue.

Definitional cross-references:	"appropriate person"	s. 1(1)
	"instruction"	s. 1(1)
	"issuer"	s. 1(1)
	"person"	s. 1(1)

Obligations of person originating an instruction

78. Unless otherwise agreed, a person originating an instruction makes only the warranties set out in sections 34 and 36 and does not warrant that the security will be honoured by the issuer.

COMMENT

Source: UCC Rev 8-305(b)

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the transfer of uncertificated securities.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-305(b).

Section 78 makes clear that the originator of an instruction, like the endorser of a security certificate, does not warrant that the issuer will honor the underlying obligation, but does make warranties as a transferor under sections 34 and 36.

Definitional cross-references:		
	"instruction"	s. 1(1)
	"issuer"	s. 1(1)
	"person"	s. 1(1)
	"security"	s. 1(1)

Signature Guarantees and Other Requisites for Registration of Transfer

Warranties by guarantor of endorser's signature

79. A person who guarantees a signature of an endorser of a security certificate warrants that, at the time of signing,

(a) the signature was genuine;

(b) the signer was the appropriate person to endorse or, if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person; and

(c) the signer had legal capacity to sign.

COMMENT

Source: UCC Rev 8-306(a)

Comparison with previous law: See OBCA s. 77(1); ABCA s. 68(1); CBCA s. 69(1); all of which are based on, and similar to (1962) UCC 8-312(1).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-306(a).

Section 79 provides that a guarantor of the signature of the endorser of a security

certificate warrants that the signature is genuine, that the signer is an appropriate person or has actual authority to endorse on behalf of the appropriate person, and that the signer has legal capacity. Section 80 provides similar, though not identical, warranties for the guarantor of a signature of the originator of an instruction for transfer of an uncertificated security.

Appropriate person is defined in s. 1(1) to include a successor or person who has power under other law to act for a person who is deceased or lacks capacity. Thus if a certificate registered in the name of Mary Roe is endorsed by Jane Doe as executor of Mary Roe, a guarantor of the signature of Jane Doe warrants that she has power to act as executor.

Although the definition of appropriate person in s. 1(1) does not itself include an agent, an endorsement by an agent is effective under s. 29 if the agent has authority to act for the appropriate person. Accordingly, this section provides an explicit warranty of authority for agents.

The rationale of the principle that a signature guarantor warrants the authority of the signer, rather than simply the genuineness of the signature, was explained in the leading case of *Jennie Clarkson Home for Children v. Missouri, K. & T. R. Co.*, 182 N.Y. 47, 74 N.E. 571, 70 A.L.R. 787 (1905), which dealt with a guarantee of the signature of a person endorsing on behalf of a corporation. "If stock is held by an individual who is executing a power of attorney for its transfer, the member of the exchange who signs as a witness thereto guaranties not only the genuineness of the signature affixed to the power of attorney, but that the person signing is the individual in whose name the stock stands. With reference to stock standing in the name of a corporation, which can only sign a power of attorney through its authorized officers or agents, a different situation is presented. If the witnessing of the signature of the corporation is only that of the signature of a person who signs for the corporation, then the guarantee is of no value, and there is nothing to protect purchasers or the companies who are called upon to issue new stock in the place of that transferred from the frauds of persons who have signed the names of corporations without authority. If such is the only effect of the guarantee, purchasers and transfer agents must first go to the corporation in whose name the stock stands and ascertain whether the individual who signed the power of attorney had authority to so do. This will require time, and in many cases will necessitate the postponement of the completion of the purchase by the payment of the money until the facts can be ascertained. The broker who is acting for the owner has an opportunity to become acquainted with his customer, and may readily before sale ascertain, in case of a corporation, the name of the officer who is authorized to execute the power of attorney. It was therefore, we think, the purpose of the rule to cast upon the broker who

witnesses the signature the duty of ascertaining whether the person signing the name of the corporation had authority to so do, and making the witness a guarantor that it is the signature of the corporation in whose name the stock stands. There are no equivalent Canadian cases to the U.S decision referred to in this Comment. That U.S. decision is part of the context to previous versions of UCC Article 8, existing Canadian law, and the STA.

Definitional cross-references:		
	"appropriate person"	s. 1(1)
	"endorsement"	s. 1(1)
	"genuine"	s. 1(1)
	"person"	s. 1(1)
	"security certificate"	s. 1(1)

Warranties by guarantor of signature of originator of instruction

80. (1) A person who guarantees a signature of the originator of an instruction warrants that, at the time of signing,

(a) the signature was genuine;

(b) if the person specified in the instruction as being the registered owner was, in fact, the registered owner, the signer was the appropriate person to originate the instruction or, if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person; and

(c) the signer had legal capacity to sign.

Limitation

(2) A person who guarantees a signature of the originator of an instruction does not by that guarantee warrant that the person who is specified in the instruction as the registered owner is in fact the registered owner.

COMMENT

Source: UCC Rev 8-306(b)

Comparison with previous law: There is no comparable provision in existing Canadian

law dealing with the transfer of uncertificated securities.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-306(b). Clause (b) of subsection (1) is drafted somewhat differently than Rev 8-306(b)(2), but no substantive difference is intended.

Subsection (1) sets forth the warranties that can reasonably be expected from the guarantor of the signature of the originator of an instruction, who, though familiar with the signer, does not have any evidence that the purported owner is in fact the owner of the subject uncertificated security. This is in contrast to the position of the person guaranteeing a signature on a certificate who can see a certificate in the signer's possession in the name of or endorsed to the signer or in blank. Thus, the warranty in clause (b) of subsection (1) is expressly conditioned on the actual registration's conforming to that represented by the originator. If the signer purports to be the owner, the guarantor under clause (b), warrants only the identity of the signer. If, however, the signer is acting in a representative capacity, the guarantor warrants both the signer's identity and authority to act for the purported owner. The issuer needs no warranty as to the facts of registration because those facts can be ascertained from the issuer's own records.

Definitional cross-references:	"appropriate person"	s. 1(1)
	"genuine"	s. 1(1)
	"instruction"	s. 1(1)
	"person"	s. 1(1)

Warranties by special guarantor of signature of originator of instruction

81. A person who specially guarantees the signature of an originator of an instruction makes the warranties of a signature guarantor under section 80 and also warrants that, at the time that the instruction is presented to the issuer,

(a) the person specified in the instruction as the registered owner of the uncertificated security will be the registered owner; and

(b) the transfer of the uncertificated security requested in the instruction will be registered by the issuer free from all liens, security interests, restrictions and claims other than those specified in the instruction.

COMMENT

Source: UCC Rev 8-306(c)

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the transfer of uncertificated securities.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-306(c).

Section 81 sets forth a "special guarantee of signature" under which the guarantor additionally warrants both registered ownership and freedom from undisclosed defects of record. The guarantor of the signature of an endorser of a security certificate effectively makes these warranties to a purchaser for value on the evidence of a clean certificate issued in the name of the endorser, endorsed to the endorser or endorsed in blank. By specially guaranteeing under s. 81, the guarantor warrants that the instruction will, when presented to the issuer, result in the requested registration free from defects not specified.

Definitional cross-references:	"instruction"	s. 1(1)
	"issuer"	s. 1(1)
	"security interest"	s. 1(1)
	"uncertificated security"	s. 1(1)

Warranty re rightfulness of transfer by guarantor

82. (1) A guarantor under section 79 or 80 or a special guarantor under section 81 does not otherwise warrant the rightfulness of the transfer.

Same

(2) A person who guarantees an endorsement of a security certificate makes the warranties of a signature guarantor under section 79 and also warrants the rightfulness of the transfer in all respects.

Same

(3) A person who guarantees an instruction that requests the transfer of an uncertificated security makes the warranties of a special signature guarantor under section 81 and also warrants the rightfulness of the transfer in all respects.

COMMENT

Source: UCC Rev 8-306(d), (e), and (f)

Comparison with previous law: See OBCA s. 77(1) and (2); ABCA s. 68(1) and (2); CBCA s. 69(1) and (2); all of which are based on, and similar to (1962) UCC 8-312(1) and (2).

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-306(d), (e), and (f).

Subsection (1) makes clear that the warranties of a signature guarantor are limited to those specified in this section and do not include a general warranty of rightfulness. On the other hand subsections (2) and (3) provide that a person guaranteeing an endorsement or an instruction does warrant that the transfer is rightful in all respects.

Definitional cross-references:		
	"endorsement"	s. 1(1)
	"person"	s. 1(1)
	"security certificate"	s. 1(1)
	"uncertificated security"	s. 1(1)

Guarantee may not be condition to registration of transfer

83. An issuer shall not require a special guarantee of signature, a guarantee of endorsement or a guarantee of instruction as a condition to the registration of transfer.

COMMENT

Source: UCC Rev 8-306(g)

Comparison with previous law: See OBCA s. 77(3); ABCA s. 68(3); CBCA s. 69(3); all of which are based on, and similar to (1962) UCC 8-312(2).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-306(g).

Section 83 makes clear what can be inferred from the combination of sections 86 and 87, that the issuer may not require as a condition to transfer a guarantee of the endorsement or instruction nor may it require a special signature guarantee.

Definitional cross-references:		
	"endorsement"	s. 1(1)
	"instruction"	s. 1(1)
	"issuer"	s. 1(1)

Liability of guarantor, endorser and originator

84. (1) The warranties under sections 79 to 82 are made to a person taking or dealing with the security in reliance on the guarantee and the guarantor is liable to the person for any loss resulting from any breach of those warranties.

Same

(2) An endorser or an originator of an instruction whose signature, endorsement or instruction has been guaranteed is liable to a guarantor for any loss suffered by the guarantor resulting from any breach of the warranties of the guarantor.

COMMENT

Source: UCC Rev 8-306(h)

Comparison with previous law: See OBCA s. 77(4); ABCA s. 68(4); CBCA s. 69(4); all of which are based on, and similar to (1962) UCC 8-312(3).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-306(h).

Section 84 specifies to whom the warranties in this section run, and also provides that a person who gives a guarantee under this section has an action against the endorser or originator for any loss suffered by the guarantor.

Definitional cross-references:	"endorsement"	s. 1(1)
	"instruction"	s. 1(1)
	"person"	s. 1(1)

Purchaser's right to requisites for registration of transfer

85. (1) Unless otherwise agreed, the transferor of a security shall, on demand, supply the purchaser with proof of authority to transfer or with any other requisite necessary to obtain registration of the transfer of the security.

Exception

(2) Despite subsection (1), if the transfer is not for value, a transferor need not comply with a demand made under subsection (1) unless the purchaser pays the necessary expenses.

Transferor's failure to comply

(3) If the transferor fails within a reasonable time to comply with the demand made under subsection (1), the purchaser may reject or rescind the transfer.

COMMENT

Source: UCC Rev 8-307

Comparison with previous law: See OBCA s. 81; ABCA s. 72; CBCA s. 73; all of which are based on, and similar to (1962) UCC 8-316.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-307.

1. Because registration of the transfer of a security is a matter of vital importance, a purchaser is here provided with the means of obtaining such formal requirements for registration as signature guarantees, proof of authority, transfer tax stamps and the like. The transferor is the one in a position to supply most conveniently whatever documentation may be requisite for registration of transfer, and the duty to do so upon

demand within a reasonable time is here stated affirmatively. If an essential item is peculiarly within the capacity of the transferor so that the transferor is the only one who can obtain it, the purchaser may specifically enforce the right to obtain it. Compare s. 74. If a transfer is not for value the transferor need not pay expenses.

2. If the transferor's duty is not performed the transferee may reject or rescind the contract to transfer. The transferee is not bound to do so. An action for damages for breach of contract may be preferred.

Definitional cross-references:	"purchaser"	s. 1(1)
	"security"	s. 1(1)
	"value"	s. 1(1) and s. 55

Part V
Registration

Duty of issuer to register transfer

86. (1) If a certificated security in registered form is presented to an issuer with a request to register a transfer of the certificated security or an instruction is presented to an issuer with a request to register a transfer of an uncertificated security, the issuer shall register the transfer as requested if,

(a) under the terms of the security, the proposed transferee is eligible to have the security registered in that person's name;

(b) the endorsement or instruction is made by the appropriate person or by an agent who has actual authority to act on behalf of the appropriate person;

(c) reasonable assurance is given that the endorsement or instruction is genuine and authorized;

(d) any applicable law relating to the collection of taxes has been complied with;

(e) the transfer does not violate any restriction on transfer imposed by statute or by the issuer in accordance with section 62;

(f) in the case of a demand made under section 88 that the issuer not register a transfer,

(i) the demand has not become effective under section 88, or

(ii) the issuer has complied with section 89, but legal process has not been obtained or an indemnity bond has not been provided to the issuer in accordance with section 90; and

(g) the transfer is rightful or is to a protected purchaser.

Liability for not registering transfer

(2) If, under subsection (1), an issuer is under a duty to register a transfer of a security, the issuer is liable to a person presenting a certificated security or an instruction for registration, or to that

person's principal, for any loss resulting from unreasonable delay in registration or the failure or refusal to register the transfer.

COMMENT

Source: UCC Rev 8-401

Comparison with previous law: See OBCA s. 86; ABCA s. 75; CBCA s. 76; all of which are based on, and similar to (1962) UCC 8-401.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-401.

1. This section states the duty of the issuer to register transfers. A duty exists only if certain preconditions exist. If any of the preconditions do not exist, there is no duty to register transfer. If an endorsement on a security certificate is a forgery, there is no duty. If an instruction to transfer an uncertificated security is not originated by an appropriate person, there is no duty. If there has not been compliance with applicable tax laws, there is no duty. If a security certificate is properly endorsed but nevertheless the transfer is in fact wrongful, there is no duty unless the transfer is to a protected purchaser (and the other preconditions exist).

This section does not constitute a mandate that the issuer must establish that all preconditions are met before the issuer registers a transfer. The issuer may waive the reasonable assurances specified in clause (1)(c). If it has confidence in the responsibility of the persons requesting transfer, it may ignore questions of compliance with tax laws. Although an issuer has no duty if the transfer is wrongful, the issuer has no duty to inquire into adverse claims, see s. 91.

In clause (1)(e), the STA adds the words "by statute" to make clear that the issuer is not obligated to register a transfer in violation of a statutory transfer restriction (e.g. s. 379 of the *Bank Act*). Clause (1) (g) allows an issuer to protect itself against sham transfers. See *Evanov v. Burlington Broadcasting Inc.*, [1997] O.J. No. 1781 (Ont. C.J.).

2. By subsection (2) the person entitled to registration may not only compel it but may hold the issuer liable in damages for unreasonable delay.

3. The definition of 'issuer' in s. 1(1) provides that, with respect to registration of transfer,

'issuer' means the person on whose behalf transfer books are maintained. Transfer agents, registrars or the like within the scope of their respective functions have rights and duties under this Part similar to those of the issuer. See s. 94.

Definitional cross-references:		
	"appropriate person"	s. 1(1)
	"certificated security"	s. 1(1)
	"endorsement"	s. 1(1)
	"genuine"	s. 1(1)
	"instruction"	s. 1(1)
	"issuer"	s. 1(1)
	"person"	s. 1(1)
	"protected purchaser"	s. 1(1)
	"registered form"	s. 1(1)
	"uncertificated security"	s. 1(1)

Assurances re endorsement or instruction

87. (1) An issuer may require the following assurance that each necessary endorsement or each instruction is genuine and authorized:

1. In all cases, a guarantee of the signature of the person making the endorsement or originating the instruction, including, in the case of an instruction, reasonable assurance of identity.
2. If the endorsement is made or the instruction is originated by an agent, appropriate assurance of actual authority to act.
3. If the endorsement is made or the instruction is originated by a fiduciary or successor referred to in clause (d) or (e) of the definition of "appropriate person" in subsection 1 (1), appropriate evidence of appointment or incumbency.
4. If there is more than one fiduciary or successor referred to in clause (d) or (e) of the definition of "appropriate person" in subsection 1 (1), reasonable assurance that all who are required to sign have done so.
5. If the endorsement is made or the instruction is originated by a person not referred to in paragraph 2, 3 or 4, assurance appropriate to the case corresponding as nearly as may be to the assurance required by paragraph 2, 3 or 4.

Same

(2) An issuer may elect to require reasonable assurance beyond that specified in this section.

Definitions

(3) In this section,

"appropriate evidence of appointment or incumbency" means,

(a) in the case of a fiduciary appointed or qualified by a court, a document issued by or under the direction or supervision of the court or an officer of the court and dated within 60 days before the date of presentation for transfer,

(b) in any other case,

(i) a copy of a document showing the appointment,

(ii) a certificate certifying the appointment issued by or on behalf of a person reasonably believed by the issuer to be a responsible person, or

(iii) in the absence of a document or certificate referred to in subclause (i) or (ii), other evidence that the issuer reasonably considers appropriate; ("preuve appropriée de la nomination ou du mandat")

"fiduciary" means any person acting in a fiduciary capacity, and includes a personal representative acting for the estate of a deceased person; ("représentant")

"guarantee" means a guarantee signed by or on behalf of a person reasonably believed by the issuer to be a responsible person. ("garantie")

Same

(4) For the purposes of the definition of "guarantee" in subsection (3), an issuer may adopt any standards with respect to responsibility so long as those standards are not manifestly unreasonable.

COMMENT

Source: UCC Rev 8-402

Comparison with previous law: See OBCA s. 87; ABCA s. 76; CBCA s. 77; all of which are based on, and similar to (1962) UCC 8-402.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-402.

1. An issuer is absolutely liable for wrongful registration of transfer if the endorsement or instruction is ineffective. See s. 91. Accordingly, an issuer is entitled to require such assurance as is reasonable under the circumstances that all necessary endorsements or instructions are effective, and thus to minimize its risk. This section establishes the requirements the issuer may make in terms of documentation which, except in the rarest of instances, should be easily furnished. Subsection (2) provides that an issuer may require additional assurances if that requirement is reasonable under the circumstances, but if the issuer demands more than reasonable assurance that the instruction or the necessary endorsements are genuine and authorized, the presenter may refuse the demand and sue for improper refusal to register. Section 86(2).

2. Under paragraph 1 of subsection (1), the issuer may require in all cases a guarantee of signature. See sections 79 and 80. When an instruction is presented the issuer always may require reasonable assurance as to the identity of the originator. Clause(3) (b) (iii) allows the issuer to require that the person making these guarantees be one reasonably believed to be responsible, and the issuer may adopt standards of responsibility which are not manifestly unreasonable. See subsection (4).

3. This section, by clauses (b) through (e) of subsection (1), permits the issuer to seek confirmation that the endorsement or instruction is genuine and authorized. The permitted methods act as a double check on matters which are within the warranties of the signature guarantor. See sections 79 and 80. Thus, an agent may be required to submit a power of attorney, a corporation to submit a certified resolution evidencing the authority of its signing officer to sign, an executor or administrator to submit a court document showing their appointment, etc. But failure of a fiduciary to obtain court approval of the transfer or to comply with other requirements does not make the fiduciary's signature ineffective. See section 30. For that reason, court orders and other controlling instruments are omitted from subsection (1).

Clause (1)(c) authorizes the issuer to require "appropriate evidence" of appointment or incumbency, and subsection (3) indicates what evidence will be "appropriate". In the case of a fiduciary appointed or qualified by a court that evidence will be a court document dated within sixty days before the date of presentation. Where the fiduciary is not appointed or qualified by a court, as in the case of a successor trustee, the issuer may require a copy of a trust instrument or other document showing the appointment, or it may require the certificate of a responsible person. In the absence of such a document or certificate, it may require other appropriate evidence. If the security is registered in the name of the fiduciary as such, the person's signature is effective even though the person is no longer serving in that capacity, see s. 31, hence no evidence of incumbency is needed.

4. Circumstances may indicate that a necessary signature was unauthorized or was not that of an appropriate person. Such circumstances would be ignored at risk of absolute liability. To minimize that risk the issuer may properly exercise the option given by subsection (2) to require assurance beyond that specified in subsection (1). On the other hand, the facts at hand may reflect only on the rightfulness of the transfer. Such facts do not create a duty of inquiry, because the issuer is not liable to an adverse claimant unless the claimant obtains legal process. See s. 91.

Definitional cross-references:

"appropriate person"	s. 1(1)
"endorsement"	s. 1(1)
"fiduciary"	s. 1(1)
"genuine"	s. 1(1)
"instruction"	s. 1(1)
"issuer"	s. 1(1)
"person"	s. 1(1)

Demand that issuer not register transfer

88. (1) A person who is the appropriate person to make an endorsement or to originate an instruction may demand that the issuer not register a transfer of a security by communicating a notice to the issuer setting out,

(a) the identity of the registered owner;

(b) the issue of which the security is a part; and

(c) an address of the person making the demand to which communications may be sent.

Effectiveness of demand

(2) A demand made under subsection (1) becomes effective when the issuer has had a reasonable opportunity to act on the demand, having regard to the time and manner of receipt of the demand by the issuer.

COMMENT

Source: UCC Rev 8-403(a)

Comparison with previous law: See OBCA s. 88(1); ABCA s. 77(1); CBCA s. 78(1); all of which are based on, and similar to (1962) UCC 8-403(1).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-403(a).

The general rule under the STA is that if there has been an effective endorsement or instruction, a person who contends that registration of the transfer would be wrongful should not be able to interfere with the registration process merely by sending notice of the assertion to the issuer. Rather, the claimant must obtain legal process. See s. 91. Section 88 is an exception to this general rule. It permits the registered owner—but not third parties—to demand that the issuer not register a transfer.

This section is intended to alleviate the problems faced by registered owners of certificated securities who lose or misplace their certificates. A registered owner who realizes that a certificate may have been lost or stolen should promptly report that fact to the issuer, lest the owner be precluded from asserting a claim for wrongful registration. See s. 93. The usual practice of issuers and transfer agents is that when a certificate is reported as lost, the owner is notified that a replacement can be obtained if the owner provides an indemnity bond. See s. 92. If the registered owner does not plan to transfer the securities, the owner might choose not to obtain a replacement, particularly if the owner suspects that the certificate has merely been misplaced.

Under this section, the owner's notification that the certificate has been lost would constitute a demand that the issuer not register transfer. No indemnity bond or legal process is necessary.

Definitional cross-references:	"appropriate person"	s. 1(1)
	"communicate"	s. 10
	"endorsement"	s. 1(1)
	"instruction"	s. 1(1)
	"issuer"	s. 1(1)
	"notification"	s. 11
	"person"	s. 1(1)
	"security"	s. 1(1)

Duty of issuer re demand to not register transfer

89. (1) If, after a demand made under section 88 becomes effective, a certificated security in registered form is presented to an issuer with a request to register a transfer or an instruction is presented to an issuer with a request to register a transfer of an uncertificated security, the issuer shall promptly give a notice as described in subsection (2) to the following persons:

1. The person who initiated the demand, at the address provided in the demand.
2. The person who presented the security for the registration of transfer or originated the instruction requesting the registration of transfer.

Substance of notice

(2) A notice given by an issuer under subsection (1) must state,

(a) that the certificated security has been presented for the registration of transfer or the instruction for the registration of transfer of the uncertificated security has been received;

(b) that a demand that the issuer not register a transfer had previously been received; and

(c) that the issuer will withhold registration of transfer for a period of time stated in the notice in order to provide the person who initiated the demand an opportunity to obtain legal process or to provide an indemnity bond referred to in section 90.

Time limit for withholding registration of transfer

(3) The period of time that may be provided for under clause (2) (c) shall not exceed 30 days from the date the notice was given and the issuer

may specify a shorter period of time in the notice so long as the shorter period of time being specified is not manifestly unreasonable.

COMMENT

Source: UCC Rev 8-403(b) and (c)

Comparison with previous law: See OBCA s. 88(2); ABCA s. 77(2); CBCA s. 78(2); all of which are based on, and similar to (1962) UCC 8-403(2).

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-403(b) and (c).

If the original certificate is presented for registration of transfer, after a demand made under s. 88 becomes effective, the issuer is required to notify the registered owner of that fact, and defer registration of transfer for a stated period. In order to prevent undue delay in the process of registration, the stated period may not exceed thirty days. This gives the registered owner an opportunity to either obtain legal process or post an indemnity bond as provided in s. 90 and thereby prevent the issuer from registering transfer.

Definitional cross-references:		
	"certificated security"	s. 1(1)
	"communication"	s. 10
	"instruction"	s. 1(1)
	"issuer"	s. 1(1)
	"notify"	s. 11
	"person"	s. 1(1)
	"uncertificated security"	s. 1(1)

Liability of issuer re demand to not register transfer

90. (1) An issuer is not liable, to a person who initiated a demand under section 88 that the issuer not register a transfer, for any loss that the person suffers as a result of the registration of a transfer in accordance with an effective endorsement or instruction if the person who initiated the demand does not, within the time stated in the issuer's notice given under section 89, either,

(a) obtain an appropriate restraining order, injunction or other process from a court of competent jurisdiction enjoining the issuer from registering the transfer; or

(b) provide the issuer with an indemnity bond sufficient in the issuer's judgment to protect the issuer and any transfer agent, registrar or other agent of the issuer involved from any loss that those persons may suffer by refusing to register the transfer.

Same

(2) Nothing in subsection (1) or in section 88 or 89 relieves an issuer from liability for registering a transfer under an endorsement or instruction that was not effective.

COMMENT

Source: UCC Rev 8-403(d) and (e)

Comparison with previous law: See OBCA s. 88(3); ABCA s. 77(3); CBCA s. 78(3); all of which are based on, and similar to (1962) UCC 8-403(3).

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-403(d) and (e).

Subsection (1) states that an issuer is not liable for registering a transfer if the person making the demand that the issuer not register the transfer fails to act in accordance with the notice given by the issuer under s. 89. Subsection (2) makes clear that this section does not relieve an issuer from liability for registering a transfer pursuant to an ineffective endorsement or instruction. An issuer's liability for wrongful registration in such cases does not depend on the presence or absence of notice that the endorsement or instruction was ineffective. For example, registered owners who are confident that they neither endorsed the certificates, nor did anything that would preclude them from denying the effectiveness of another's endorsement (see sections 29 and 93) might prefer to pursue their rights against the issuer for wrongful registration rather than take advantage of the opportunity to post a bond or seek a restraining order when notified by the issuer under this section that their lost certificates have been presented for registration in apparently good order.

Definitional cross-references:		
	"effective"	s. 1(1) and sections 29-32
	"endorsement"	s. 1(1)

	"instruction"	s. 1(1)
	"issuer"	s. 1(1)
	"person"	s. 1(1)

Wrongful registration of transfer

91. (1) Except as otherwise provided in section 93, an issuer is liable for wrongful registration of transfer if,

(a) the issuer has registered a transfer of a security to a person not entitled to the security; and

(b) the transfer was registered by the issuer,

(i) under an ineffective endorsement or instruction,

(ii) after a demand that the issuer not register a transfer became effective under section 88 and the issuer did not comply with section 89,

(iii) after the issuer had been served with an injunction, restraining order or other legal process referred to in section 90 enjoining the issuer from registering the transfer and the issuer had a reasonable opportunity to obey or otherwise abide by the injunction, restraining order or other legal process, or

(iv) acting in collusion with the wrongdoer.

Liability

(2) An issuer that is liable for the wrongful registration of transfer under subsection (1) shall, on demand, provide the person entitled to the security with,

(a) a like certificated or uncertificated security, as the case may be; and

(b) any payments or distributions that the person did not receive as a result of the wrongful registration.

Overissue

(3) If the provision of a security under subsection (2) would result in an overissue, the issuer's liability to provide the person with a like security is governed by section 67.

Limitation

(4) Except as otherwise provided in subsection (1) or in any applicable law of Canada or of any province or territory of Canada relating to the collection of taxes, an issuer is not liable to an owner or other person suffering loss as a result of the registration of transfer of a security if the registration was made under an effective endorsement or instruction.

COMMENT

Source: UCC Rev 8-404

Comparison with previous law: See OBCA s. 89; ABCA s. 78; CBCA s. 79; all of which are based on, and similar to (1962) UCC 8-404.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-404.

1. Clause (1)(a) provides that an issuer is liable if it registers transfer pursuant to an endorsement or instruction that was not effective. For example, an issuer that registers transfer on a forged endorsement is liable to the registered owner. The fact that the issuer had no reason to suspect that the endorsement was forged or that the issuer obtained the ordinary assurances under s. 87 does not relieve the issuer from liability. The reason that issuers obtain signature guaranties and other assurances is that they are liable for wrongful registration.

Subsections (2) and (3) specify the remedies for wrongful registration. Pre-UCC cases established the registered owner's right to receive a new security where the issuer had wrongfully registered a transfer, but some cases also allowed the registered owner to elect between an equitable action to compel issue of a new security and an action for damages. Cf. *Casper v. Kalt-Zimmers Mfg. Co.*, 159 Wis. 517, 149 N.W. 754 (1914). The STA does not allow such election. The true owner of a certificated security is required to take a new security except where an overissue would result and a similar security is not reasonably available for purchase. See s. 67. The true owner of an uncertificated

security is entitled and required to take restoration of the records to their proper state, with a similar exception for overissue.

2. Read together, subsections (4) and (1) have the effect of providing that an issuer has no duties to an adverse claimant unless the claimant serves legal process on the issuer to enjoin registration. Mere commencement of legal proceedings is not sufficient; the legal process must enjoin the issuer from registering the transfer as described in s. 90. Issuers, or their transfer agents, perform a record-keeping function for the direct holding system that is analogous to the functions performed by clearing agencies and securities intermediaries in the indirect holding system. This section applies to the record-keepers for the direct holding system the same standard that s. 54 applies to the record-keepers for the indirect holding system. Thus, issuers are not liable to adverse claimants merely on the basis of notice. As in the case of the analogous rules for the indirect holding system, the policy of this section is to protect the right of investors to have their securities transfers processed without the disruption or delay that might result if the record-keepers risked liability to third parties. It would be undesirable to apply different standards to the direct and indirect holding systems, since doing so might operate as a disincentive to the development of a book-entry direct holding system.

3. This section changes prior law under which an issuer could be held liable, even though it registered transfer on an effective endorsement or instruction, if the issuer had in some fashion been notified that the transfer might be wrongful against a third party, and the issuer did not appropriately discharge its duty to inquire into the adverse claim. See, e.g., OBCA s. 88; ABCA s. 77; and CBCA s. 78.

The rule of former OBCA s. 88; ABCA s. 77; and CBCA s. 78 was anomalous inasmuch as s. 64 and similar provisions in existing Canadian law provide that the issuer is entitled to "treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner". Under s. 64, the fact that a third person notifies the issuer of a claim does not preclude the issuer from treating the registered owner as the person entitled to the security. See *Kerrigan v. American Orthodontics Corp.*, 960 F.2d 43 (7th Cir. 1992). The change made in the present version of s. 91 ensures that the rights of registered owners and the duties of issuers with respect to registration of transfer will be protected against third-party interference in the same fashion as other rights of registered ownership.

This Comment refers to a number of American cases to which there are no equivalent Canadian cases. The U.S. decisions are part of the context to previous versions of UCC Article 8, existing Canadian law, and the STA.

Definitional cross-references:		
	"certificated security"	s. 1(1)
	"collusion"	s. 1(1)
	"endorsement"	s. 1(1)
	"effective"	s. 1(1) and sections 29-32
	"instruction"	s. 1(1)
	"issuer"	s. 1(1)
	"overissue"	s. 1(1)
	"person"	s. 1(1)
	"security"	s. 1(1)
	"uncertificated security"	s. 1(1)

Replacement of security certificate lost, etc.

92. (1) If an owner of a certificated security, whether in registered form or bearer form, claims that the security certificate has been lost, destroyed or wrongfully taken, the issuer shall issue a new security certificate if the owner,

(a) so requests before the issuer has notice that the lost, destroyed or wrongfully taken security certificate has been acquired by a protected purchaser;

(b) provides the issuer with an indemnity bond sufficient in the issuer's judgment to protect the issuer from any loss that the issuer may suffer by issuing a new certificate; and

(c) satisfies any other reasonable requirements imposed by the issuer.

Where protected purchaser presents certificate after replacement issued

(2) If, after the issue of a new security certificate, a protected purchaser of the original security certificate presents the original security certificate for the registration of transfer, the issuer,

(a) shall register the transfer unless the registration would result in an overissue, in which case the issuer's liability is governed by section 67;

(b) may exercise the rights the issuer may have under the indemnity bond referred to in clause (1) (b); and

(c) may recover the new security certificate from a person to whom it was issued or from any person, other than a protected purchaser, taking under that person.

COMMENT

Source: UCC Rev 8-405

Comparison with previous law: See OBCA s. 90(2), (3), and (4); ABCA s. 79(2), (3), and (4); CBCA s. 80(2), (3), and (4); all of which are based on, and similar to (1962) UCC 8-405(2) and (3), which are similar to s. 17 of the 1909 *Uniform Stock Transfer Act*.

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-405.

1. This section enables the owner to obtain a replacement of a lost, destroyed or stolen certificate, provided that reasonable requirements are satisfied and a sufficient indemnity bond supplied.

2. Where an "original" security certificate has reached the hands of a protected purchaser, the registered owner—who was in the best position to prevent the loss, destruction or theft of the security certificate—is now deprived of the new security certificate issued as a replacement. This changes the pre-UCC law under which the original certificate was ineffective after the issue of a replacement except insofar as it might represent an action for damages in the hands of a purchaser for value without notice. *Keller v. Eureka Brick Mach. Mfg. Co.*, 43 Mo.App. 84, 11 L.R.A. 472 (1890). Where both the original and the new certificate have reached protected purchasers the issuer is required to honor both certificates unless an overissue would result and the security is not reasonably available for purchase. See s. 67. In the latter case alone, the protected purchaser of the original certificate is relegated to an action for damages. In either case, the issuer itself may recover on the indemnity bond.

This Comment refers to an American case to which there are no equivalent Canadian cases. The U.S. decision is part of the context to previous versions of UCC Article 8, existing Canadian law, and the STA.

Definitional cross-references:		
	"bearer form"	s. 1(1)
	"certificated security"	s. 1(1)
	"issuer"	s. 1(1)
	"notice"	s. 11
	"overissue"	s. 1(1)
	"person"	s. 1(1)
	"protected purchaser"	s. 1(1)

	"registered form"	s. 1(1)
	"security certificate"	s. 1(1)

Obligation to notify issuer of lost, destroyed or wrongfully taken security certificate

93. An owner of a security may not assert against the issuer a claim for wrongful registration of transfer under section 91 or a claim to a new security certificate under section 92 if,

(a) a security certificate has been lost, apparently destroyed or wrongfully taken and the owner fails to give a notice to the issuer of that fact within a reasonable time after the owner has notice of it; and

(b) the issuer registers a transfer of the security before receiving a notice of the loss, apparent destruction or wrongful taking of the security certificate.

COMMENT

Source: UCC Rev 8-406

Comparison with previous law: See OBCA s. 90(1); ABCA s. 79(1); CBCA s. 80(1); all of which are based on, and similar to (1962) UCC 8-405(1).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-406.

An owner who fails to notify the issuer within a reasonable time after the owner knows or has reason to know of the loss or theft of a security certificate is estopped from asserting the ineffectiveness of a forged or unauthorized endorsement and the wrongfulness of the registration of the transfer. If the lost certificate was endorsed by the owner, then the registration of the transfer was not wrongful under s. 91, unless the owner made an effective demand that the issuer not register transfer under s. 88.

Definitional cross-references:	"issuer"	s. 1(1)
	"notify"	s. 11
	"security certificate"	s. 1(1)

Obligation of authenticating trustee, transfer agent, etc.

94. A person acting as authenticating trustee, registrar, transfer agent or other agent for an issuer in the registration of a transfer of the issuer's securities, in the issue of new security certificates or uncertificated securities or in the cancellation of surrendered security certificates has the same obligation to the holder or owner of a certificated or uncertificated security with regard to the particular function performed as the issuer has in regard to that function.

COMMENT

Source: UCC Rev 8-407

Comparison with previous law: See OBCA s. 91(1); ABCA s. 80(1); CBCA s. 81(1); all of which are based on, and similar to (1962) UCC 8-406(1).

Explanation: This provision is intended to be substantively uniform with the corresponding provision of Rev 8-407.

1. Transfer agents, registrars, and the like are here expressly held liable both to the issuer and to the owner for wrongful refusal to register a transfer as well as for wrongful registration of a transfer in any case within the scope of their respective functions where the issuer would itself be liable. Those cases which have regarded these parties solely as agents of the issuer and have therefore refused to recognize their liability to the owner for mere non-feasance, i.e., refusal to register a transfer, are rejected. *Hulse v. Consolidated Quicksilver Mining Corp.*, 65 Idaho 768, 154 P.2d 149 (1944); *Nicholson v. Morgan*, 119 Misc. 309, 196 N.Y.Supp. 147 (1922); *Lewis v. Hargadine-McKittrick Dry Goods Co.*, 305 Mo. 396, 274 S.W. 1041 (1924).

2. The practice frequently followed by authenticating trustees of issuing certificates of indebtedness rather than authenticating duplicate certificates where securities have been lost or stolen became obsolete in view of the provisions of s. 92, which makes express provision for the issue of substitute securities. It is not a breach of trust or lack of due diligence for trustees to authenticate new securities. Cf. *Switzerland General Ins. Co. v. N.Y.C. & H.R.R. Co.*, 152 App.Div. 70, 136 N.Y.S. 726 (1912).

This Comment refers to a number of American cases to which there are no equivalent Canadian cases. The U.S. decisions are part of the context to previous versions of UCC Article 8, existing Canadian law, and the STA.

Definitional cross-references:	"certificated security"	s. 1(1)
	"issuer"	s. 1(1)
	"person"	s. 1(1)
	"security"	s. 1(1)
	"security certificate"	s. 1(1)
	"uncertificated security"	s. 1(1)

Part VI
Security Entitlements

Acquisition of security entitlement

95. (1) Except as otherwise provided in subsections (3) and (4), a person acquires a security entitlement if a securities intermediary,

(a) indicates by book entry that a financial asset has been credited to the person's securities account;

(b) receives a financial asset from the person or acquires a financial asset for the person and, in either case, accepts it for credit to the person's securities account; or

(c) becomes obligated under another statute, law, regulation or rule to credit a financial asset to the person's securities account.

Same

(2) If a condition of subsection (1) has been met, a person has a security entitlement even if the securities intermediary does not itself hold the financial asset.

Holding financial asset directly

(3) A person is to be treated as holding a financial asset directly rather than as having a security entitlement with respect to the financial asset if a securities intermediary holds the financial asset for that person and the financial asset,

(a) is registered in the name of, payable to the order of or specially endorsed to that person; and

(b) has not been endorsed to the securities intermediary or in blank.

Issuance of security

(4) Issuance of a security is not establishment of a security entitlement.

COMMENT

Source: UCC Rev 8-501(b) to (e)

Comparison with previous law: The provisions in this section, together with the rest of Part 6, reflect a new and different approach to describing the property interest of a person who holds securities or other financial assets through a securities intermediary. This new approach describes the property interest as a "security entitlement". It explicitly rejects previous law by omitting most of previous 8-313, upon which were based OBCA s. 78, ABCA s. 69 and CBCA s. 70; and omitting all of previous 8-320, upon which is based OBCA s. 85.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-501.

1. Part 6 rules apply to security entitlements, and s. 95(1) provides that a person has a security entitlement when a financial asset has been credited to a "securities account". Thus, the term "securities account" specifies the type of arrangements between institutions and their customers that are covered by Part 6. A securities account is a consensual arrangement in which the intermediary undertakes to treat the customer as entitled to exercise the rights that comprise the financial asset. The consensual aspect is covered by the requirement that the account be established pursuant to agreement. The term agreement is used in the broad sense; there is no requirement that a formal or written agreement be signed.

As the securities business is presently conducted, several significant relationships clearly fall within the definition of a securities account, including the relationship between a clearing agency and its participants, a broker and customers who leave securities with the broker, and a bank or trust company acting as securities custodian and its custodial customers. Given the enormous variety of arrangements concerning securities that exist today, and the certainty that new arrangements will evolve in the future, it is not possible to specify all of the arrangements to which the term does and does not apply.

Whether an arrangement between a firm and another person concerning a security or other financial asset is a securities account under the STA depends on whether the firm has undertaken to treat the other person as entitled to exercise the rights that comprise the security or other financial asset. The provisions of the STA are intended to be construed and applied to promote their underlying purposes and policies. Thus, the question whether a given arrangement is a securities account should be decided not by dictionary analysis of the words of the definition taken out of context, but by considering whether it promotes the objectives of the STA to include the arrangement within the term securities account.

The effect of concluding that an arrangement is a securities account is that the rules of Part 6 apply. Accordingly, the definition of "securities account" must be interpreted in light of the substantive provisions in Part 6, which describe the core features of the type of relationship for which the commercial law rules of the STA concerning security entitlements were designed. There are many arrangements between institutions and other persons concerning securities or other financial assets which do not fall within the definition of "securities account" because the institutions have not undertaken to treat the other persons as entitled to exercise the ordinary rights of an entitlement holder specified in the Part 6 rules. For example, the term securities account does not cover the relationship between a bank and its depositors or the relationship between a trustee and the beneficiary of an ordinary trust, because those are not relationships in which the holder of a financial asset has undertaken to treat the other as entitled to exercise the rights that comprise the financial asset in the fashion contemplated by the Part 6 rules.

In short, the primary factor in deciding whether an arrangement is a securities account is whether application of the Part 6 rules is consistent with the expectations of the parties to the relationship. Relationships not governed by Part 6 may be governed by other parts of the STA if the relationship gives rise to a new security, or may be governed by other law entirely.

2. Subsection (1) of this section specifies what circumstances give rise to security entitlements. Clause (a) of subsection (1) sets out the most important rule. It turns on the intermediary's conduct, reflecting a basic operating assumption of the indirect holding system that once a securities intermediary has acknowledged that it is carrying a position in a financial asset for its customer or participant, the intermediary is obligated to treat the customer or participant as entitled to the financial asset. Clause (a) does not attempt to specify exactly what accounting, record-keeping, or information transmission steps suffice to indicate that the intermediary has credited the account. That is left to agreement, trade practice, or rule in order to provide the flexibility necessary to accommodate varying or changing accounting and information processing systems. The point of paragraph clause (a) is that once an intermediary has acknowledged that it is carrying a position for the customer or participant, the customer or participant has a security entitlement. The precise form in which the intermediary manifests that acknowledgment is left to private ordering.

Clause (b) of subsection (1) sets out a different operational test, turning not on the intermediary's accounting system but on the facts that accounting systems are supposed to represent. Under clause (1)(b) a person has a security entitlement if the intermediary has received and accepted a financial asset for credit to the account of its customer or participant. For example, if a customer of a broker or bank or trust company custodian

delivers a security certificate in proper form to the broker, bank or trust company to be held in the customer's account, the customer acquires a security entitlement. Clause (b) also covers circumstances in which the intermediary receives a financial asset from a third person for credit to the account of the customer or participant. Clause (1)(b) is not limited to circumstances in which the intermediary receives security certificates or other financial assets in physical form. The clause also covers circumstances in which the intermediary acquires a security entitlement with respect to a financial asset which is to be credited to the account of the intermediary's own customer. For example, if a customer transfers her account from Broker A to Broker B, she acquires security entitlements against Broker B once the clearing agency has credited the positions to Broker B's account. It should be noted, however, clause (1)(b) provides that a person acquires a security entitlement when the intermediary not only receives but also accepts the financial asset for credit to the account. This limitation is included to take account of the fact that there may be circumstances in which an intermediary has received a financial asset but is not willing to undertake the obligations that flow from establishing a security entitlement. For example, a security certificate which is sent to an intermediary may not be in proper form, or may represent a type of financial asset which the intermediary is not willing to carry for others. It should be noted that in all but extremely unusual cases, the circumstances covered by clause (1)(b) will also be covered by paragraph clause (1)(a), because the intermediary will have credited the positions to the customer's account.

Clause (c) of subsection (1) sets out a residual test, to avoid any implication that the failure of an intermediary to make the appropriate entries to credit a position to a customer's securities account would prevent the customer from acquiring the rights of an entitlement holder under Part 6. As is the case with the clause (1)(b) test, the clause (1)(c) test would not be needed for the ordinary cases, since they are covered by clause (1)(a).

3. In a sense, section 95(1) is analogous to the rules set out in the provisions of previous law, such as OBCA s. 78(1)(c) and (e), and s. 85 that specified what acts by a securities intermediary or clearing agency sufficed as a transfer of securities held in fungible bulk. Unlike that previous law, however, this section is not based on the idea that an entitlement holder acquires rights only by virtue of a “transfer” from the securities intermediary to the entitlement holder. In the indirect holding system, the significant fact is that the securities intermediary has undertaken to treat the customer as entitled to the financial asset. It is up to the securities intermediary to take the necessary steps to ensure that it will be able to perform its undertaking. It is, for example, entirely possible that a securities intermediary might make entries in a customer's account reflecting that customer's acquisition of a certain security at a time when the securities intermediary did

not itself happen to hold any units of that security. The person from whom the securities intermediary bought the security might have failed to deliver and it might have taken some time to clear up the problem, or there may have been an operational gap in time between the crediting of a customer's account and the receipt of securities from another securities intermediary. The entitlement holder's rights against the securities intermediary do not depend on whether or when the securities intermediary acquired its interests. Subsection (2) is intended to make this point clear. Subsection (2) does not mean that the intermediary is free to create security entitlements without itself holding sufficient financial assets to satisfy its entitlement holders. The duty of a securities intermediary to maintain sufficient assets is governed by section 98 and regulatory law. Subsection (2) is included only to make it clear the question whether a person has acquired a security entitlement does not depend on whether the intermediary has complied with that duty.

4. STA Part 6 sets out a carefully designed system of rules for the indirect holding system. Persons who hold securities through brokers or custodians have security entitlements that are governed by Part 6, rather than being treated as the direct holders of securities. Subsection (3) specifies the limited circumstance in which a customer who leaves a financial asset with a broker or other securities intermediary has a direct interest in the financial asset, rather than a security entitlement.

The customer can be a direct holder only if the security certificate, or other financial asset, is registered in the name of, payable to the order of, or specially endorsed to the customer, and has not been endorsed by the customer to the securities intermediary or in blank. The distinction between those circumstances where the customer can be treated as direct owner and those where the customer has a security entitlement is essentially the same as the distinction drawn under Part XII of the *Bankruptcy and Insolvency Act* between "customer name securities" and the "customer pool fund". The distinction does not turn on any form of physical identification or segregation. A customer who delivers certificates to a broker with blank endorsements or stock powers is not a direct holder but has a security entitlement, even though the broker holds those certificates in some form of separate safe-keeping arrangement for that particular customer. The customer remains the direct holder only if there is no endorsement or stock power so that further action by the customer is required to place the certificates in a form where they can be transferred by the broker.

The rule of subsection (3) corresponds to the rule set out in s. 68(1)(c) specifying when acquisition of possession of a certificate by a securities intermediary counts as "delivery" to the customer.

5. Subsection (4) is intended to make clear that Part 6 does not apply to an

arrangement in which a security is issued representing an interest in underlying assets, as distinguished from arrangements in which the underlying assets are carried in a securities account. A common mechanism by which new financial instruments are devised is that a financial institution that holds some security, financial instrument, or pool thereof, creates interests in that asset or pool which are sold to others. In many such cases, the interests so created will fall within the definition of "security" in s.1(1). If so, then by virtue of s. 95(4), the relationship between the institution that creates the interests and the persons who hold them is not a security entitlement to which the Part 6 rules apply. Accordingly, an arrangement such as a depositary receipt facility which creates freely transferable interests in underlying securities will be issuance of a security under the STA rather than establishment of a security entitlement to the underlying securities.

The subsection (4) rule can be regarded as an aspect of the definitional rules specifying the meaning of securities account and security entitlement. Among the key components of the definition of security in s.1(1) are the "transferability" and "divisibility" tests. Securities, in the STA sense, are fungible interests or obligations that are intended to be tradable. The concept of security entitlement under Part 6 is quite different. A security entitlement is the package of rights that a person has against the person's own intermediary with respect to the positions carried in the person's securities account. That package of rights is not, as such, something that is traded. When a customer sells a security that she had held through a securities account, her security entitlement is terminated; when she buys a security that she will hold through her securities account, she acquires a security entitlement. In most cases, settlement of a securities trade will involve termination of one person's security entitlement and acquisition of a security entitlement by another person. That transaction, however, is not a "transfer" of the same entitlement from one person to another. That is not to say that an entitlement holder cannot transfer an interest in her security entitlement as such; granting a security interest in a security entitlement is such a transfer. On the other hand, the nature of a security entitlement is that the intermediary is undertaking duties only to the person identified as the entitlement holder.

Definitional cross-references:		
	"endorsement"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"person"	s. 1(1)
	"securities account"	s. 1(1)
	"securities intermediary"	s. 1(1)
	"security"	s. 1(1)
	"security entitlement"	s. 1(1)
	"security interest"	s. 1(1)

Protection of entitlement holders from adverse claim

96. A legal proceeding based on an adverse claim to a financial asset, however framed, may not be brought against a person who acquires a security entitlement under section 95 for value and without notice of the adverse claim.

COMMENT

Source: UCC Rev 8-502

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-502.

1. Section 96 provides investors in the indirect holding system with protection against adverse claims by specifying that no adverse claim can be asserted against a person who acquires a security entitlement under s. 95 for value and without notice of the adverse claim. It plays a role in the indirect holding system analogous to the rule of the direct holding system that protected purchasers take free from adverse claims (s. 70).

This section does not use the locution "takes free from adverse claims" because that could be confusing as applied to the indirect holding system. The nature of indirect holding system is that an entitlement holder has an interest in common with others who hold positions in the same financial asset through the same intermediary. Thus, a particular entitlement holder's interest in the financial assets held by its intermediary is necessarily "subject to" the interests of others. See s. 97. The rule stated in this section might have been expressed by saying that a person who acquires a security entitlement under s. 95 for value and without notice of adverse claims takes "that security entitlement" free from adverse claims. That formulation has not been used, however, for fear that it would be misinterpreted as suggesting that the person acquires a right to the underlying financial assets that could not be affected by the competing rights of others claiming through common or higher tier intermediaries. A security entitlement is a complex bundle of rights. This section does not deal with the question of what rights are in the bundle. Rather, this section provides that once a person has acquired the bundle, someone else cannot take it away on the basis of assertion that the transaction in which the security entitlement was created involved a violation of the claimant's rights.

2. Because securities trades are typically settled on a net basis by book-entry movements, it would ordinarily be impossible for anyone to trace the path of any particular security, no matter how the interest of parties who hold through intermediaries is described. Suppose, for example, that S has a 1000 share position in XYZ common stock through an account with a broker, Able & Co. S's identical twin impersonates S and directs Able to sell the securities. That same day, B places an order with Baker & Co., to buy 1000 shares of XYZ common stock. Later, S discovers the wrongful act and seeks to recover "her shares". Even if S can show that, at the stage of the trade, her sell order was matched with B's buy order, that would not suffice to show that "her shares" went to B. Settlement between Able and Baker occurs on a net basis for all trades in XYZ that day; indeed Able's net position may have been such that it received rather than delivered shares in XYZ through the settlement system.

In the unlikely event that this was the only trade in XYZ common stock executed in the market that day, one could follow the shares from S's account to B's account. The plaintiff in an action in conversion or similar legal action to enforce a property interest must show that the defendant has an item of property that belongs to the plaintiff. In this example, B's security entitlement is not the same item of property that formerly was held by S, it is a new package of rights that B acquired against Baker under s. 95. Principles of equitable remedies might, however, provide S with a basis for contending that if the position B received was the traceable product of the wrongful taking of S's property by S's twin, a constructive trust should be imposed on B's property in favour of S. See for example G. H. L. Fridman, *Restitution*, 2nd ed. (Scarborough: Carswell, 1992) at pp. 417-46. Section 96 ensures that no such claims can be asserted against a person, such as B in this example, who acquires a security entitlement under s. 95 for value and without notice, regardless of what theory of law or equity is used to describe the basis of the assertion of the adverse claim.

In the above example, S would ordinarily have no reason to pursue B unless Able is insolvent and S's claim will not be satisfied in the insolvency proceedings. Because S did not give an entitlement order for the disposition of her security entitlement, Able must recredit her account for the 1000 shares of XYZ common stock. See s. 101(3) and (4).

3. The following examples illustrate the operation of s. 96.

Example 1. Thief steals bearer bonds from Owner. Thief delivers the bonds to Broker for credit to Thief's securities account, thereby acquiring a security entitlement under s. 95(1). Under other law, Owner may have a claim to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that Thief misappropriated.

Because Thief was himself the wrongdoer, Thief obviously had notice of Owner's adverse claim. Accordingly, s. 96 does not preclude Owner from asserting an adverse claim against Thief.

Example 2. Thief steals bearer bonds from Owner. Thief owes a personal debt to Creditor. Creditor has a securities account with Broker. Thief agrees to transfer the bonds to Creditor as security for or in satisfaction of his debt to Creditor. Thief does so by sending the bonds to Broker for credit to Creditor's securities account. Creditor thereby acquires a security entitlement under s. 95(1). Under other law, Owner may have a claim to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that Thief misappropriated. Creditor acquired the security entitlement for value, since Creditor acquired it as security for or in satisfaction of Thief's debt to Creditor (see the definition of value in s. 1(1)). If Creditor did not have notice of Owner's claim, s. 96 precludes any action by Owner against Creditor, whether framed in constructive trust or other theory. Sections 18-22 specify what counts as notice of an adverse claim.

Example 3. Father, as trustee for Son, holds XYZ Co. shares in a securities account with Able & Co. In violation of his fiduciary duties, Father sells the XYZ Co. shares and uses the proceeds for personal purposes. Father dies, and his estate is insolvent. Assume—implausibly—that Son is able to trace the XYZ Co. shares and show that the "same shares" ended up in Buyer's securities account with Baker & Co. s. 96 precludes any action by Son against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

Example 4. Debtor holds XYZ Co. shares in a securities account with Able & Co. As collateral for a loan from Bank, Debtor grants Bank a security interest in the security entitlement to the XYZ Co. shares. Bank perfects by a method which leaves Debtor with the ability to dispose of the shares (e.g. by registration; see PPSA s. 23. In violation of the security agreement, Debtor sells the XYZ Co. shares and absconds with the proceeds. Assume—implausibly—that Bank is able to trace the XYZ Co. shares and show that the "same shares" ended up in Buyer's securities account with Baker & Co. If Buyer acquired the security entitlement for value and did not know that there was a breach of the security agreement, then Bank's claim is precluded by the PPSA cut-off rules. See PPSA s. 28(8)-(10). Bank's claim does not meet the definition of "adverse claim" but, if it did, section 96 precludes any action by Bank against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

Example 5. Debtor owns controlling interests in various public companies, including Acme and Ajax. Acme owns 60% of the stock of another public company, Beta. Debtor causes the Beta stock to be pledged to Lending Bank as collateral for Ajax's debt. Acme holds the Beta stock through an account with a securities custodian, C Bank, which in turn holds through Clearing Agency. Lending Bank is also a Clearing Agency participant. The pledge of the Beta stock is implemented by Acme instructing C Bank to instruct Clearing Agency to debit C Bank's account and credit Lending Bank's account. Acme and Ajax both become insolvent. The Beta stock is still valuable. Acme's liquidator asserts that the pledge of the Beta stock for Ajax's debt was wrongful as against Acme and seeks to recover the Beta stock from Lending Bank. Because the pledge was implemented by an outright transfer into Lending Bank's account at Clearing Agency, Lending Bank acquired a security entitlement to the Beta stock under s. 95(1). Lending Bank acquired the security entitlement for value, since it acquired it as security for a debt (see the definition of value in s. 1(1)). If Lending Bank did not have notice of Acme's claim, s. 96 will preclude any action by Acme against Lending Bank, whether framed in constructive trust or other theory.

Example 6. Debtor grants Alpha Co. a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha also has an account with Able. Debtor instructs Able to transfer the shares to Alpha, and Able does so by crediting the shares to Alpha's account. Alpha has control of the 1000 shares under s. 25(1). (The facts to this point are identical to those in Example 1 in the Comment to s. 25, except that Alpha Co. was Alpha Bank.) Alpha next grants Beta Co. a security interest in the 1000 shares included in Alpha's security entitlement. See PPSA s. 17.1. Alpha instructs Able to transfer the shares to Gamma Co., Beta's custodian. Able does so, and Gamma credits the 1000 shares to Beta's account. Beta now has control under s. 25(1). By virtue of Debtor's explicit permission or by virtue of the permission inherent in Debtor's creation of a security interest in favour of Alpha and Alpha's resulting power to grant a security interest under PPSA s. 17.1, Debtor has no adverse claim to assert against Beta, assuming implausibly that Debtor could "trace" an interest to the Gamma account. Moreover, even if Debtor did hold an adverse claim, if Beta did not have notice of Debtor's claim, s. 96 will preclude any action by Debtor against Beta, whether framed in constructive trust or other theory.

4. Although this section protects entitlement holders against adverse claims, it does not protect them against the risk that their securities intermediary will not itself have sufficient financial assets to satisfy the claims of all of its entitlement holders. Suppose that Customer A holds 1000 shares of XYZ Co. stock in an account with her broker, Able & Co. Able in turn holds 1000 shares of XYZ Co. through its account with Clearing Agency, but has no other positions in XYZ Co. shares, either for other customers or for

its own proprietary account. Customer B places an order with Able for the purchase of 1000 shares of XYZ Co. stock, and pays the purchase price. Able credits B's account with a 1000 share position in XYZ Co. stock, but Able does not itself buy any additional XYZ Co. shares. Able fails, having only 1000 shares to satisfy the claims of A and B. Unless other insolvency law establishes a different distributional rule, A and B would share the 1000 shares held by Able pro rata, without regard to the time that their respective entitlements were established. See s. 97(2). Section 96 protects entitlement holders, such as A and B, against adverse claimants. In this case, however, the problem that A and B face is not that someone is trying to take away their entitlements, but that the entitlements are not worth what they thought. The only role that s. 96 plays in this case is to preclude any assertion that A has some form of claim against B by virtue of the fact that Able's establishment of an entitlement in favour of B diluted A's rights to the limited assets held by Able.

Definitional cross-references:		
	"adverse claim"	s. 1(1)
	"fiduciary"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"notice of an adverse claim"	sections 18-22
	"person"	s. 1(1)
	"security entitlement"	s. 1(1)
	"security interest"	s. 1(1)
	"value"	s. 1(1) and s. 55

Property interest of entitlement holders in financial asset

97. (1) To the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that financial asset held by the securities intermediary,

(a) are held by the securities intermediary for the entitlement holders;

(b) are not the property of the securities intermediary; and

(c) are not subject to claims of creditors of the securities intermediary, except as otherwise provided in section 105.

Proportionate interest

(2) An entitlement holder's property interest with respect to a particular financial asset under subsection (1) is a proportionate property

interest in all interests in that financial asset held by the securities intermediary, without regard to,

(a) the time that the entitlement holder acquired the security entitlement; or

(b) the time that the securities intermediary acquired the interest in that financial asset.

Enforcement of property interest against securities intermediary

(3) An entitlement holder's property interest with respect to a particular financial asset under subsection (1) may be enforced against the securities intermediary only by the exercise of the entitlement holder's rights under sections 99 to 102.

Enforcement of property interest against purchaser

(4) An entitlement holder's property interest with respect to a particular financial asset under subsection (1) may be enforced against a purchaser of the financial asset, or interest in it, only if,

(a) bankruptcy or insolvency proceedings have been initiated by or against the securities intermediary;

(b) the securities intermediary does not have sufficient interests in the financial asset to satisfy the security entitlements of all of its entitlement holders to that financial asset;

(c) the securities intermediary violated its obligations under section 98 by transferring the financial asset, or interest in it, to the purchaser; and

(d) the purchaser is not protected under subsection (7).

Recovery by trustee or liquidator

(5) For the purposes of subsection (4), a trustee or other liquidator acting on behalf of all entitlement holders having security entitlements with respect to a particular financial asset may recover the financial asset, or interest in it, from the purchaser.

Recovery by entitlement holder

(6) If the trustee or other liquidator elects not to pursue the right provided under subsection (5), an entitlement holder whose security entitlement remains unsatisfied has the right to recover the entitlement holder's interest in the financial asset from the purchaser.

Protection of purchaser for value

(7) A legal proceeding based on the entitlement holder's property interest with respect to a particular financial asset under subsection (1), however framed, may not be brought against any purchaser of a financial asset, or interest in it, who,

(a) gives value;

(b) obtains control or possession; and

(c) does not act in collusion with the securities intermediary in violating the securities intermediary's obligations under section 98.

COMMENT

Source: UCC Rev 8-503

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-503.

1. This section specifies the sense in which a security entitlement is an interest in the property held by the securities intermediary. It expresses the ordinary understanding that securities that a firm holds for its customers are not general assets of the firm subject to the claims of creditors. Since securities intermediaries generally do not segregate securities in such fashion that one could identify particular securities as the ones held for customers, it would not be realistic for this section to state that "customers' securities" are not subject to creditors' claims. Rather subsection (1) provides that to the extent necessary to satisfy all customer claims, all units of that security held by the firm are held

for the entitlement holders, are not property of the securities intermediary, and are not subject to creditors' claims, except as otherwise provided in s. 105.

An entitlement holder's property interest under this section is an interest with respect to a specific issue of securities or financial assets. For example, customers of a firm who have positions in XYZ common stock have security entitlements with respect to the XYZ common stock held by the intermediary, while other customers who have positions in ABC common stock have security entitlements with respect to the ABC common stock held by the intermediary.

Subsection (2) makes clear that the property interest described in subsection (2) is an interest held in common by all entitlement holders who have entitlements to a particular security or other financial asset. Temporal factors are irrelevant. One entitlement holder cannot claim that its rights to the assets held by the intermediary are superior to the rights of another entitlement holder by virtue of having acquired those rights before, or after, the other entitlement holder. Nor does it matter whether the intermediary had sufficient assets to satisfy all entitlement holders' claims at one point, but no longer does. Rather, all entitlement holders have a pro rata interest in whatever positions in that financial asset the intermediary holds.

Although this section describes the property interest of entitlement holders in the assets held by the intermediary, it does not necessarily determine how property held by a failed intermediary will be distributed in bankruptcy or insolvency proceedings. If the intermediary fails and its affairs are being administered in a bankruptcy or insolvency proceeding, the applicable bankruptcy or insolvency law governs how the various parties having claims against the firm are treated. For example, the distributional rules under Part XII of the *Bankruptcy and Insolvency Act*, entitled "Securities Firm Bankruptcies", provide that the "customer pool fund" is distributed pro rata among all customers in proportion to their "net equity", rather than dividing the property on an issue by issue basis. For intermediaries that are not subject to the *Bankruptcy and Insolvency Act*, other insolvency law would determine what distributional rule is applied.

2. Although this section recognizes that the entitlement holders of a securities intermediary have a property interest in the financial assets held by the intermediary, the incidents of this property interest are established by the rules of the STA, not by common law property concepts. The traditional rules on certificated securities were based on the idea that a paper certificate could be regarded as a nearly complete reification of the underlying right. The rules on transfer and the consequences of wrongful transfer could then be written using the same basic concepts as the rules for physical chattels. A person's claim of ownership of a certificated security is a right to a specific identifiable

physical object, and that right can be asserted against any person who ends up in possession of that physical certificate, unless cut off by the rules protecting purchasers for value without notice. Those concepts do not work for the indirect holding system. A security entitlement is not a claim to a specific identifiable thing; it is a package of rights and interests that a person has against the person's securities intermediary and the property held by the intermediary. The idea that discrete objects might be traced through the hands of different persons has no place in the STA rules for the indirect holding system. The fundamental principles of the indirect holding system rules are that an entitlement holder's own intermediary has the obligation to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the financial asset, and that the entitlement holder can look only to that intermediary for performance of the obligations. The entitlement holder cannot assert rights directly against other persons, such as other intermediaries through whom the intermediary holds the positions, or third parties to whom the intermediary may have wrongfully transferred interests, except in extremely unusual circumstances where the third party was itself a participant in the wrongdoing. Subsections (3) through (7) reflect these fundamental principles.

Subsection (3) provides that an entitlement holder's property interest can be enforced against the intermediary only by exercise of the entitlement holder's rights under sections 99 through 102. These are the provisions that set out the duty of an intermediary to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the security. If the intermediary is in bankruptcy or insolvency proceedings and can no longer perform in accordance with the ordinary Part 6 rules, the applicable bankruptcy or insolvency law will determine how the intermediary's assets are to be distributed.

Subsections (4) through (7) specify the limited circumstances in which an entitlement holder's property interest can be asserted against a third person to whom the intermediary transferred a financial asset that was subject to the entitlement holder's claim when held by the intermediary. Subsections (4) through (6) provide that the property interest of entitlement holders cannot be asserted against any transferee except in the circumstances therein specified. So long as the intermediary is solvent, the entitlement holders must look to the intermediary to satisfy their claims. UCC Rev 8-503(d)(1) refers to "insolvency proceedings", while STA s. 97(4)(a) refers to "bankruptcy or insolvency proceedings". No substantive difference is intended. "Insolvency proceedings" is defined in UCC 1-201(b)(22) to include "an assignment for the benefit of creditors or other proceedings intended to liquidate or rehabilitate the estate of the person involved". The additional reference to bankruptcy in STA s. 97(4)(a) is intended to avoid any possible confusion arising from the fact that the *Bankruptcy and Insolvency*

Act defines an "insolvent person" as someone who is not bankrupt. The provision is intended to include proceedings under the *Bankruptcy and Insolvency Act*, *Companies' Creditors Arrangement Act*, or *Winding-up and Restructuring Act*. If the intermediary does not hold financial assets corresponding to the entitlement holders' claims, the intermediary has the duty to acquire them. See s. 98. Thus, clauses (a), (b), and (c) of subsection (4) specify that the only occasion in which the entitlement holders can pursue transferees is when the intermediary is unable to perform its obligation, and the transfer to the transferee was a violation of those obligations. Even in that case, a transferee who gave value and obtained control is protected by virtue of the rule in subsection (7), unless the transferee acted in collusion with the intermediary.

Subsections (4) through (7) have the effect of protecting transferees from an intermediary against adverse claims arising out of assertions by the intermediary's entitlement holders that the intermediary acted wrongfully in transferring the financial assets. These rules, however, operate in a slightly different fashion than traditional adverse claim cut-off rules. Rather than specifying that a certain class of transferee takes free from all claims, subsections (4) through (7) specify the circumstances in which this particular form of claim can be asserted against a transferee. The STA also contains general adverse claim cut-off rules for the indirect holding system. See sections 96 and 104. The rule of subsections (4) through (7) take precedence over the general cut-off rules of those sections, because s. 97 itself defines and sets limits on the assertion of the property interest of entitlement holders. Thus, the question whether entitlement holders' property interest can be asserted as an adverse claim against a transferee from the intermediary is governed by the collusion test of s. 97(7), rather than by the "without notice" test of sections 96 and 104.

3. The limitations that subsections (3) through (7) place on the ability of customers of a failed intermediary to recover securities or other financial assets from transferees are consistent with the fundamental policies of investor protection that underlie the STA and other bodies of law governing the securities business. The commercial law rules for the securities holding and transfer system must be assessed from the forward-looking perspective of their impact on the vast number of transactions in which no wrongful conduct occurred or will occur, rather than from the *post hoc* perspective of what rule might be most advantageous to a particular class of persons in litigation that might arise out of the occasional case in which someone has acted wrongfully. Although one can devise hypothetical scenarios where particular customers might find it advantageous to be able to assert rights against someone other than the customers' own intermediary, commercial law rules that permitted customers to do so would impair rather than promote the interest of investors and the safe and efficient operation of the clearance and settlement system. Suppose, for example, that Intermediary A transfers securities to

B, that Intermediary A acted wrongfully as against its customers in so doing, and that after the transaction Intermediary A did not have sufficient securities to satisfy its obligations to its entitlement holders. Viewed solely from the standpoint of the customers of Intermediary A, it would seem that permitting the property to be recovered from B, would be good for investors. That, however, is not the case. B may itself be an intermediary with its own customers, or may be some other institution through which individuals invest, such as a pension fund or investment company. There is no reason to think that rules permitting customers of an intermediary to trace and recover securities that their intermediary wrongfully transferred work to the advantage of investors in general. To the contrary, application of such rules would often merely shift losses from one set of investors to another. The uncertainties that would result from rules permitting such recoveries would work to the disadvantage of all participants in the securities markets.

The use of the collusion test in s. 97(7) furthers the interests of investors generally in the sound and efficient operation of the securities holding and settlement system. The effect of the choice of this standard is that customers of a failed intermediary must show that the transferee from whom they seek to recover was affirmatively engaged in wrongful conduct, rather than casting on the transferee any burden of showing that the transferee had no awareness of wrongful conduct by the failed intermediary. The rule of s. 97(7) is based on the long-standing policy that it is undesirable to impose upon purchasers of securities any duty to investigate whether their sellers may be acting wrongfully.

Rather than imposing duties to investigate, the general policy of the commercial law of the securities holding and transfer system has been to eliminate legal rules that might induce participants to conduct investigations of the authority of persons transferring securities on behalf of others for fear that they might be held liable for participating in a wrongful transfer. The rules in Part 5 of the STA concerning transfers by fiduciaries provide a good example. Under *Lowry v. Commercial & Farmers' Bank*, 15 F. Cas. 1040 (C.C.D. Md. 1848) (No. 8551), an issuer could be held liable for wrongful transfer if it registered transfer of securities by a fiduciary under circumstances where it had any reason to believe that the fiduciary may have been acting improperly. In one sense that seems to be advantageous for beneficiaries who might be harmed by wrongful conduct by fiduciaries. The consequence of the *Lowry* rule, however, was that in order to protect against risk of such liability, issuers developed the practice of requiring extensive documentation for fiduciary stock transfers, making such transfers cumbersome and time consuming. Accordingly, the rules in Part 4 of UCC Article 8 in the U.S., upon which similar provisions in existing Canadian law were based, and in the prior fiduciary transfer statutes in the U.S., were designed to discourage transfer agents from conducting investigations into the rightfulness of transfers by fiduciaries.

The *Lowry* decision referred to above was a departure from previous U.S. law, which had followed the English position that a company was not bound to notice trusts of its stock (see *Hartga* v. *Bank of England* (1796), 3 Ves. Jun. 56, 30 E.R. 891 (Ch.); *Bank of Virginia* v. *Craig* (1835), 32 Va. (6 Leigh) 399; *Hutchins* v. *State Bank* (1847), 52 Mass. (12 Metc.) 421). This principle was reflected in early English and Canadian corporate legislation (see for example s. 25 of the 1864 *Act to authorize the granting of Charters of Incorporation, etc.* (27 & 28 Vict. c. 23), and it remains in s. 199(1) of the *Canada Corporations Act* (R.S.C. 1970, c. C-32), which says: "The company is not bound to see to the execution of any trust, whether express, implied or constructive, in respect of any share". There is, however, no analogous provision in the CBCA or provincial BCAs, apparently because such Acts dealt with the issue by copying Part 4 of prior versions of UCC Article 8. The issue raised by the U.S. *Lowry* decision has apparently not been addressed in any Canadian decision under the CBCA or provincial BCAs and one objective of Part 5 of the STA is to preclude any possibility of a decision similar to *Lowry* being made under Canadian law.

The rules of the STA implement for the indirect holding system the same policies that the rules on protected purchasers and registration of transfer adopt for the direct holding system. A securities intermediary is, by definition, a person who is holding securities on behalf of other persons. There is nothing unusual or suspicious about a transaction in which a securities intermediary sells securities that it was holding for its customers. That is exactly what securities intermediaries are in business to do. The interests of customers of securities intermediaries would not be served by a rule that required counterparties to transfers from securities intermediaries to investigate whether the intermediary was acting wrongfully against its customers. Quite the contrary, such a rule would impair the ability of securities intermediaries to perform the function that customers want.

The rules of s. 97(3) through (7) apply to transferees generally, including pledgees. The reasons for treating pledgees in the same fashion as other transferees are discussed in the Comment to s. 105. The statement in subsection (1) that an intermediary holds financial assets for customers and not as its own property does not, of course, mean that the intermediary lacks power to transfer the financial assets to others. For example, although the PPSAs provide that for a security interest to attach the debtor must have "rights" in the collateral, (see PPSA s. 11(2)(b)), the fact that an intermediary is holding a financial asset in a form that permits ready transfer means that it has such rights, even if the intermediary is acting wrongfully against its entitlement holders in granting the security interest. The question whether the secured party takes subject to the entitlement holder's claim in such a case is governed by s. 105, which is an application to secured

transactions of the general principles expressed in subsections (4) through (7) of this section.

Definitional cross-references:		
	"control"	s. 1(1)
	"entitlement holder"	s. 1(1)
	"fiduciary"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"in collusion"	s. 1(1)
	"purchaser"	s. 1(1) and s. 55
	"secured party"	s. 1(1)
	"securities intermediary"	s. 1(1)
	"security entitlement"	s. 1(1)
	"security interest"	s. 1(1)
	"value"	s. 1(1) and s. 55

Duty of securities intermediary re financial asset

98. (1) A securities intermediary shall promptly obtain and then maintain a financial asset in a quantity corresponding to the aggregate of all security entitlements that the securities intermediary has established in favour of its entitlement holders with respect to that financial asset.

Same

(2) The securities intermediary may maintain the financial assets referred to in subsection (1) directly or through one or more other securities intermediaries.

Same

(3) Except to the extent otherwise agreed to by its entitlement holder, a securities intermediary may not grant any security interests in a financial asset it is obligated to maintain under subsection (1).

Standard of care

(4) A securities intermediary satisfies the duty imposed under subsection (1) if,

(a) the securities intermediary acts with respect to the duty as agreed to by the entitlement holder and the securities intermediary; or

(b) in the absence of an agreement referred to in clause (a), the securities intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset.

Exception

(5) This section does not apply to a clearing agency that is itself the obligor of an option or similar obligation to which its entitlement holders have security entitlements.

COMMENT

Source: UCC Rev 8-504

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-504.

1. This section expresses one of the core elements of the relationships for which the Part 6 rules were designed, to wit, that a securities intermediary undertakes to hold financial assets corresponding to the security entitlements of its entitlement holders. The locution "shall promptly obtain and shall thereafter maintain" is taken from the corresponding regulation under U.S. federal securities law (17 C.F.R. § 240.15c3-3). Comparable Canadian regulatory provisions are found in provincial securities regulations and SRO rules (e.g. Regulation 2000 and By-Law 17.3 of the Investment Dealers Association of Canada (IDA) dealing with the segregation of fully paid or excess margin securities). The phrase "shall promptly obtain and shall thereafter maintain" is compatible with Canadian practice. This section recognizes the reality that, as the securities business is conducted today, it is not possible to identify particular securities as belonging to customers as distinguished from other particular securities that are the firm's own property. Securities firms typically keep all securities in fungible form, and may maintain their inventory of a particular security in various locations and forms, including physical securities held in vaults or in transit to transfer agents, and book entry positions at one or more clearing agencies. Accordingly, this section states that a securities intermediary shall maintain a quantity of financial assets corresponding to the aggregate of all security entitlements it has established. Subsection (2) provides explicitly that the securities intermediary may hold directly or indirectly. That point is implicit in the use of the term "financial asset,"

inasmuch as s. 1(2) provides that the term "financial asset" may refer either to the underlying asset or the means by which it is held, including both security certificates and security entitlements.

2. Subsection (3) states explicitly a point that is implicit in the notion that a securities intermediary must maintain financial assets corresponding to the security entitlements of its entitlement holders, to wit, that it is wrongful for a securities intermediary to grant security interests in positions that it needs to satisfy customers' claims, except as authorized by the customers. This statement does not determine the rights of a secured party to whom a securities intermediary wrongfully grants a security interest; that issue is governed by s. 97 and s. 105.

Margin accounts are common examples of arrangements in which an entitlement holder authorizes the securities intermediary to grant security interests in the positions held for the entitlement holder. Securities firms commonly obtain the funds needed to provide margin loans to their customers by "rehypothecating" the customers' securities. In order to facilitate rehypothecation, agreements between margin customers and their brokers commonly authorize the broker to commingle securities of all margin customers for rehypothecation to the lender who provides the financing. Brokers commonly rehypothecate customer securities having a value somewhat greater than the amount of the loan made to the customer, since the lenders who provide the necessary financing to the broker need some cushion of protection against the risk of decline in the value of the rehypothecated securities. The extent and manner in which a firm may rehypothecate customers' securities are determined by the agreement between the intermediary and the entitlement holder and by applicable regulatory and other law (e.g. IDA By-Law 27; PPSA s. 17.1).

3. The statement in this section that an intermediary must obtain and maintain financial assets corresponding to the aggregate of all security entitlements it has established is intended only to capture the general point that one of the key elements that distinguishes securities accounts from other relationships, such as deposit accounts, is that the intermediary undertakes to maintain a direct correspondence between the positions it holds and the claims of its customers. This section is not intended as a detailed specification of precisely how the intermediary is to perform this duty, nor whether there may be special circumstances in which an intermediary's general duty is excused. Accordingly, the general statement of the duties of a securities intermediary in this and the following sections is supplemented by two other provisions. First, each of sections 98 through 102 contains an "agreement/due care" provision. Second, s. 103 sets out general qualifications on the duties stated in these sections, including the important point that compliance with corresponding regulatory provisions constitutes compliance with the

STA duties.

4. The "agreement/due care" provision in subsection (4) of this section is necessary to provide sufficient flexibility to accommodate the general duty stated in subsection (1) to the wide variety of circumstances that may be encountered in the modern securities holding system. For the most common forms of publicly traded securities, the modern depository-based indirect holding system has made the likelihood of an actual loss of securities remote, though correctable errors in accounting or temporary interruptions of data processing facilities may occur. Indeed, one of the reasons for the evolution of book-entry systems is to eliminate the risk of loss or destruction of physical certificates. There are, however, some forms of securities and other financial assets which must still be held in physical certificated form, with the attendant risk of loss or destruction. Risk of loss or delay may be a more significant consideration in connection with foreign securities. A Canadian securities intermediary may well be willing to hold a foreign security in a securities account for its customer, but the intermediary may have relatively little choice of or control over foreign intermediaries through which the security must in turn be held. Accordingly, it may be common for Canadian securities intermediaries to disclaim responsibility for custodial risk of holding through foreign intermediaries.

Clause (4)(a) provides that a securities intermediary satisfies the duty stated in subsection (1) if the intermediary acts with respect to that duty in accordance with the agreement between the intermediary and the entitlement holder. Clause (4)(b) provides that if there is no agreement on the matter, the intermediary satisfies the subsection (1) duty if the intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset in question. This formulation does not state that the intermediary has a universally applicable statutory duty of due care. Section 5(2) provides that statutory duties of due care cannot be disclaimed by agreement, but the "agreement/due care" formula contemplates that there may be particular circumstances where the parties do not wish to create a specific duty of due care, for example, with respect to foreign securities. Under clause (4)(a), compliance with the agreement constitutes satisfaction of the subsection (1) duty, whether or not the agreement provides that the intermediary will exercise due care.

In each of the sections where the "agreement/due care" formula is used, it provides that entering into an agreement and performing in accordance with that agreement is a method by which the securities intermediary may satisfy the statutory duty stated in that section. Accordingly, the general obligation of good faith performance of statutory and contract duties (see s. 4), would apply to such an agreement. It would not be consistent with the obligation of good faith performance for an agreement to purport to establish the usual sort of arrangement between an intermediary and entitlement holder, yet disclaim

altogether one of the basic elements that define that relationship. For example, an agreement stating that an intermediary assumes no responsibilities whatsoever for the safekeeping of any of the entitlement holder's securities positions would not be consistent with good faith performance of the intermediary's duty to obtain and maintain financial assets corresponding to the entitlement holder's security entitlements". See *Powers v. American Express Financial Advisors* (2000), 82 F. Supp. 2d 448 (D. Md.), *aff'd*, (2000), 43 U.C.C. Rep. Serv. 2d (West) 425 (4th Cir.).

To the extent that no agreement under subsection Clause (4)(a) has specified the details of the intermediary's performance of the subsection (1) duty, clause (4)(b) provides that the intermediary satisfies that duty if it exercises due care in accordance with reasonable commercial standards. The duty of care includes both care in the intermediary's own operations and care in the selection of other intermediaries through whom the intermediary holds the assets in question. The statement of the obligation of due care is meant to incorporate the principles of the common law under which the specific actions or precautions necessary to meet the obligation of care are determined by such factors as the nature and value of the property, the customs and practices of the business, and the like.

5. This section necessarily states the duty of a securities intermediary to obtain and maintain financial assets only at the very general and abstract level. For the most part, these matters are specified in great detail by regulatory law. Brokers registered under the provincial securities laws are subject to detailed regulation concerning the safeguarding of customer securities and credit balances. See for example IDA Regulations 1200 and 2000, and IDA By-Law 17.3. Section 103 provides explicitly that if a securities intermediary complies with such regulatory law, that constitutes compliance with s. 98. In certain circumstances, these rules permit a firm to be in a position where it temporarily lacks a sufficient quantity of financial assets to satisfy all customer claims. For example, if another firm has failed to make a delivery to the firm in settlement of a trade, the firm is permitted a certain period of time to clear up the problem before it is obligated to obtain the necessary securities from some other source. See IDA Regulations 800 and 2000.9.

6. Subsection (5) is intended to recognize that there are some circumstances, where the duty to maintain a sufficient quantity of financial assets does not apply because the intermediary is not holding anything on behalf of others. For example, CDCC is treated as a "securities intermediary" under the STA, although it does not itself hold options on behalf of its participants. Rather, it becomes the issuer of the options, by virtue of guaranteeing the obligations of participants in the clearing agency who have written or purchased the options cleared through it. See s. 15. Accordingly, the general duty of an

intermediary under subsection (1) does not apply, nor would other provisions of Part 6 that depend upon the existence of a requirement that the securities intermediary hold financial assets, such as s. 97 and s. 102.

Definitional cross-references:		
	"clearing agency"	s. 1(1)
	"entitlement holder"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"secured party"	s. 1(1)
	"securities intermediary"	s. 1(1)
	"security entitlement"	s. 1(1)
	"security interest"	s. 1(1)

Duty of securities intermediary re payments and distributions

99. (1) A securities intermediary shall take action to obtain a payment or distribution made by the issuer of a financial asset.

Same

(2) A securities intermediary is obligated to its entitlement holder for a payment or distribution made by the issuer of a financial asset if the payment or distribution is received by the securities intermediary.

Standard of care

(3) A securities intermediary satisfies the duty imposed under subsection (1) if,

(a) the securities intermediary acts with respect to the duty as agreed to by the entitlement holder and the securities intermediary; or

(b) in the absence of an agreement referred to in clause (a), the securities intermediary exercises due care in accordance with reasonable commercial standards to attempt to obtain the payment or distribution.

COMMENT

Source: UCC Rev 8-505

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-505.

1. One of the core elements of the securities account relationships for which the Part 6 rules were designed is that the securities intermediary passes through to the entitlement holders the economic benefit of ownership of the financial asset, such as payments and distributions made by the issuer. Subsection (1) expresses the ordinary understanding that a securities intermediary will take appropriate action to see to it that any payments or distributions made by the issuer are received. One of the main reasons that investors make use of securities intermediaries is to obtain the services of a professional in performing the record-keeping and other functions necessary to ensure that payments and other distributions are received.

2. Subsection (3) incorporates the same "agreement/due care" formula as the other provisions of Part 6 dealing with the duties of a securities intermediary. See Comment 4 to s. 98. This formulation permits the parties to specify by agreement what action, if any, the intermediary is to take with respect to the duty to obtain payments and distributions. In the absence of specification by agreement, the intermediary satisfies the duty if the intermediary exercises due care in accordance with reasonable commercial standards. The provisions of s. 103 also apply to the s. 99 duty, so that compliance with applicable regulatory requirements constitutes compliance with the s. 99 duty.

3. Subsection (2) provides that a securities intermediary is obligated to its entitlement holder for those payments or distributions made by the issuer that are in fact received by the intermediary. It does not deal with the details of the time and manner of payment. Moreover, as with any other monetary obligation, the obligation to pay may be subject to other rights of the obligor, by way of set-off counterclaim or the like. S. 99(2) makes this point explicit.

Definitional cross-references:		
	"entitlement holder"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"securities intermediary"	s. 1(1)
	"security entitlement"	s. 1(1)

Duty of securities intermediary to exercise rights

100. (1) A securities intermediary shall exercise rights with respect to a financial asset if directed to do so by an entitlement holder.

Standard of care

(2) A securities intermediary satisfies the duty imposed under subsection (1) if,

(a) the securities intermediary acts with respect to the duty as agreed to by the entitlement holder and the securities intermediary; or

(b) in the absence of an agreement referred to in clause (a), the securities intermediary either,

(i) places the entitlement holder in a position to exercise the rights directly, or

(ii) exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder.

COMMENT

Source: Rev 8-506

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-506.

1. Another of the core elements of the securities account relationships for which the Part 6 rules were designed is that although the intermediary may, by virtue of the structure of the indirect holding system, be the party who has the power to exercise the corporate and other rights that come from holding the security, the intermediary exercises these powers as representative of the entitlement holder rather than at its own discretion. This characteristic is one of the things that distinguishes a securities account from other arrangements where one person holds securities "on behalf of" another, such as the relationship between a mutual fund and its shareholders or a trustee and its beneficiary. The duties of a trustee in procuring rights arising from securities were considered in *Brill v. National Trust Co.*, [1994] 3 W.W.R. 85 (B.C.S.C.).

2. The fact that the intermediary exercises the rights of security holding as representative of the entitlement holder does not, of course, preclude the entitlement holder from conferring discretionary authority upon the intermediary. Arrangements are not uncommon in which investors do not wish to have their intermediaries forward proxy materials or other information. Thus, this section provides that the intermediary shall exercise corporate and other rights "if directed to do so" by the entitlement holder. Moreover, as with the other Part 6 duties, the "agreement/due care" formulation is used in stating how the intermediary is to perform this duty. This section also provides that the intermediary satisfies the duty if it places the entitlement holder in a position to exercise the rights directly. This is to take account of the fact that some of the rights attendant upon ownership of the security, such as rights to bring derivative and other litigation, are far removed from the matters that intermediaries are expected to perform.

3. This section, and the two that follow, deal with the aspects of securities holding that are related to investment decisions. For example, one of the rights of holding a particular security that would fall within the purview of this section would be the right to exercise a conversion right for a convertible security. It is quite common for investors to confer discretionary authority upon another person, such as an investment adviser, with respect to these rights and other investment decisions. Because this section, and the other sections of Part 6, all specify that a securities intermediary satisfies the Part 6 duties if it acts in accordance with the entitlement holder's agreement, there is no inconsistency between the statement of duties of a securities intermediary and these common arrangements. See *Seaboard Life Insurance Co. v. Bank of Montreal*, 2002 BCCA 192; [2002] B.C.J. No. 599; (2002) 166 B.C.A.C. 64; (2002) 23 B.L.R. (3d) 163.

4. Section 103 also applies to the s. 100 duty, so that compliance with applicable regulatory requirements constitutes compliance with this duty. This is quite important in this context, since the provincial securities laws establish a comprehensive system of regulation of the distribution of proxy materials and exercise of voting rights with respect to securities held through brokers and other intermediaries (e.g. National Instrument 54-101 — Communication With Beneficial Owners Of Securities Of Reporting Issuers). By virtue of s. 103, compliance with such regulatory requirement constitutes compliance with the s. 100 duty.

Definitional cross-references:	"entitlement holder"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"securities intermediary"	s. 1(1)
	"security entitlement"	s. 1(1)

Duty of securities intermediary to comply with entitlement order

101. (1) A securities intermediary shall comply with an entitlement order if,

(a) the entitlement order is originated by the appropriate person;

(b) the securities intermediary has had a reasonable opportunity to assure itself that the entitlement order is genuine and authorized; and

(c) the securities intermediary has had a reasonable opportunity to comply with the entitlement order.

Liability if financial asset wrongly transferred

(2) If a securities intermediary transfers a financial asset under an ineffective entitlement order, the securities intermediary shall,

(a) re-establish a security entitlement in favour of the person entitled to it; and

(b) pay or credit any payments or distributions that the person did not receive as a result of the wrongful transfer.

Same

(3) If a securities intermediary does not re-establish a security entitlement in accordance with subsection (2), the securities intermediary is liable to the entitlement holder for damages.

Standard of care

(4) A securities intermediary satisfies the duty imposed under subsection (1) if,

(a) the securities intermediary acts with respect to the duty as agreed to by the entitlement holder and the securities intermediary; or

(b) in the absence of an agreement referred to in clause (a), the securities intermediary exercises due care in accordance with reasonable commercial standards to comply with the entitlement order.

COMMENT

Source: UCC Rev 8-507

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-507.

1. Subsection (1) of this section states another aspect of duties of securities intermediaries that make up security entitlements—the securities intermediary's duty to comply with entitlement orders. One of the main reasons for holding securities through securities intermediaries is to enable rapid transfer in settlement of trades. Thus the right to have one's orders for disposition of the security entitlement honored is an inherent part of the relationship. Subsections (2) and (3) state the correlative liability of a securities intermediary for transferring a financial asset from an entitlement holder's account pursuant to an entitlement order that was not effective.

2. The duty to comply with entitlement orders is subject to several qualifications. The intermediary has a duty only with respect to an entitlement order that is in fact originated by the appropriate person. Moreover, the intermediary has a duty only if it has had reasonable opportunity to assure itself that the order is genuine and authorized, and reasonable opportunity to comply with the order. The same "agreement/due care" formula is used in this section as in the other Part 6 sections on the duties of intermediaries, and the rules of s. 103 apply to the s. 101 duty.

3. Appropriate person is defined in s. 1(1). In the usual case, the appropriate person is the entitlement holder. Entitlement holder is defined in s. 1(1) as the person "identified in the records of a securities intermediary as the person having a security entitlement". Thus, the general rule is that an intermediary's duty with respect to entitlement orders runs only to the person with whom the intermediary has established a relationship. One of the basic principles of the indirect holding system is that securities intermediaries owe duties only to their own customers. See also s. 54. The only situation in which a securities intermediary has a duty to comply with entitlement orders originated by a person other than the person with whom the intermediary established a relationship is covered by the definition of "appropriate person" in s. 1(1), which provide that the term "appropriate person" includes the successor or personal representative of a deceased person, or the custodian or guardian of a person who lacks capacity. If the entitlement

holder is competent, another person does not fall within the defined term "appropriate person" merely by virtue of having power to act as an agent for the entitlement holder. Thus, an intermediary is not required to determine at its peril whether a person who purports to be authorized to act for an entitlement holder is in fact authorized to do so. If an entitlement holder wishes to be able to act through agents, the entitlement holder can establish appropriate arrangements in advance with the securities intermediary.

One important application of this principle is that if an entitlement holder grants a security interest in its security entitlements to a third-party lender, the intermediary owes no duties to the secured party, unless the intermediary has entered into a "control" agreement in which it agrees to act on entitlement orders originated by the secured party. See STA Part 2, especially s. 25. Even though the security agreement or some other document may give the secured party authority to act as agent for the debtor, that would not make the secured party an "appropriate person" to whom the securities intermediary owes duties. If the entitlement holder and securities intermediary have agreed to such a control arrangement, then the intermediary's action in following instructions from the secured party would satisfy the s. 101(1) duty. Although an agent, such as the secured party in this example, is not an "appropriate person," an entitlement order is "effective" if originated by an authorized person. See the definition of "appropriate person" in s. 1(1) and s. 29, which states when an entitlement order is "effective". Moreover, s. 101(4) provides that the intermediary satisfies its duty if it acts in accordance with the entitlement holder's agreement.

4. Section 101(2) and (3) provide that an intermediary is liable for a wrongful transfer if the entitlement order was "ineffective". Section 29 specifies whether an entitlement order is effective. An "effective entitlement order" is different from an "entitlement order originated by an appropriate person". An entitlement order is effective under s. 29 if it is made by the appropriate person, or by a person who has power to act for the appropriate person under the law of agency, or if the appropriate person has ratified the entitlement order or is precluded from denying its effectiveness. Thus, although a securities intermediary does not have a duty to act on an entitlement order originated by the entitlement holder's agent, the intermediary is not liable for wrongful transfer if it does so.

Section 101 (2) and (3), together with s. 29, have the effect of leaving to other law most of the questions relating to the allocation between the securities intermediary and the entitlement holder of the risk of fraudulent entitlement orders.

5. The term entitlement order does not cover all directions that a customer might give a broker concerning securities held through the broker. The STA is not a codification of all

of the law of customers and stockbrokers. The STA deals with the settlement of securities trades, not the trades. The term entitlement order does not refer to instructions to a broker to make trades, that is, enter into contracts for the purchase or sale of securities. Rather, the entitlement order is the mechanism of transfer for securities held through intermediaries, just as endorsements and instructions are the mechanism for securities held directly. In the ordinary case the customer's direction to the broker to deliver the securities at settlement is implicit in the customer's instruction to the broker to sell. The distinction is, however, significant in that this section has no application to the relationship between the customer and broker with respect to the trade itself. For example, assertions by a customer that it was damaged by a broker's failure to execute a trading order sufficiently rapidly or in the proper manner are not governed by the STA.

Definitional cross-references:		
	"appropriate person"	s. 1(1)
	"effective"	s. 29-32
	"entitlement holder"	s. 1(1)
	"entitlement order"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"secured party"	s. 1(1)
	"securities intermediary"	s. 1(1)
	"security entitlement"	s. 1(1)
	"security interest"	s. 1(1)

Duty of securities intermediary re entitlement holder's direction

102. (1) A securities intermediary shall act at the direction of an entitlement holder,

(a) to change a security entitlement into another available form of holding for which the entitlement holder is eligible; or

(b) to cause the financial asset to be transferred to a securities account of the entitlement holder with another securities intermediary.

Standard of care

(2) A securities intermediary satisfies the duty imposed under subsection (1) if,

(a) the securities intermediary acts with respect to the duty as agreed to by the entitlement holder and the securities intermediary; or

(b) in the absence of an agreement referred to in clause (a), the securities intermediary exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder.

COMMENT

Source: UCC Rev 8-508

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-508.

1. This section states another aspect of the duties of securities intermediaries that make up security entitlements—the obligation of the securities intermediary to change an entitlement holder's position into any other form of holding for which the entitlement holder is eligible or to transfer the entitlement holder's position to an account at another intermediary. This section does not state unconditionally that the securities intermediary is obligated to turn over a certificate to the customer or to cause the customer to be registered on the books of the issuer, because the customer may not be eligible to hold the security directly. Some securities are now issued in "book-entry only" form, in which the only entity that the issuer will register on its own books is a depository such as CDS.

If security certificates in registered form are issued for the security, and individuals are eligible to have the security registered in their own name, the entitlement holder can request that the intermediary deliver or cause to be delivered to the entitlement holder a certificate registered in the name of the entitlement holder or a certificate endorsed in blank or specially endorsed to the entitlement holder. If security certificates in bearer form are issued for the security, the entitlement holder can request that the intermediary deliver or cause to be delivered a certificate in bearer form. If the security can be held by individuals directly in uncertificated form, the entitlement holder can request that the security be registered in its name. The specification of this duty does not determine the pricing terms of the agreement in which the duty arises.

2. The same "agreement/due care" formula is used in this section as in the other Part 6 sections on the duties of intermediaries. So too, the rules of s. 103 apply to the s. 102 duty.

Definitional cross-references:	"entitlement holder"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"securities intermediary"	s. 1(1)
	"security entitlement"	s. 1(1)

Duties of securities intermediary – general
Compliance with other statute, etc.

103. (1) If the substance of a duty imposed on a securities intermediary under section 98, 99, 100, 101 or 102 is the subject of another statute, regulation or rule, compliance with that other statute, regulation or rule satisfies the duty.

Limits on securities intermediary's duties

(2) The obligation of a securities intermediary to perform the duties imposed under sections 98 to 102 is subject to,

(a) the rights of the securities intermediary arising out of a security interest, whether that security interest arises under a security agreement with the entitlement holder or otherwise; and

(b) the rights of the securities intermediary under another statute, law, regulation, rule or agreement to withhold performance of its duties as a result of unfulfilled obligations of the entitlement holder to the securities intermediary.

Actions prohibited by law

(3) Nothing in sections 98 to 102 requires a securities intermediary to take any action that is prohibited by another statute, regulation or rule.

Commercially reasonable standard

(4) To the extent that specific standards for the performance of any duties of a securities intermediary or the exercise of the rights of an entitlement holder are not specified by another statute, regulation or rule or by agreement between the securities intermediary and the

entitlement holder, the securities intermediary shall perform its duties and the entitlement holder shall exercise the entitlement holder's rights in a commercially reasonable manner.

COMMENT

Source: UCC Rev 8-509

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-509.

The STA is not a comprehensive statement of the law governing the relationship between brokers or other securities intermediaries and their customers. Most of the law governing that relationship is the common law of contract and agency, supplemented or supplanted by regulatory law. The STA deals only with the most basic commercial/property law principles governing the relationship. Although sections 98 through 102 specify certain duties of securities intermediaries to entitlement holders, the point of these sections is to identify what it means to have a security entitlement, not to specify the details of performance of these duties.

For many intermediaries, regulatory law specifies in great detail the intermediary's obligations on such matters as safekeeping of customer property, distribution of proxy materials, and the like. To avoid any conflict between the general statement of duties in the STA and the specific statement of intermediaries' obligations in such regulatory schemes, subsection (1) provides that compliance with applicable regulation constitutes compliance with the duties specified in sections 98 through 102. The corollary of this provision is that nothing in the STA diminishes or otherwise affects requirements imposed by regulatory law (e.g., National Instrument 54-101 — Communication With Beneficial Owners Of Securities Of Reporting Issuers; Part 6 of National Instrument 81-102 — Mutual Funds; IDA By-Law 17 and Regulations 1200 and 2000).

Definitional cross-references:		
	"entitlement holder"	s. 1(1)
	"financial asset"	s. 1(1) and s. 1(2)
	"securities intermediary"	s. 1(1)
	"security entitlement"	s. 1(1)
	"security interest"	s. 1(1)

"security interest"	s. 1(1)

Rights of purchaser re adverse claim

104. (1) In a case not covered by the priority rules under the *Personal Property Security Act* or the rules set out in subsection (3), a legal proceeding based on an adverse claim to a financial asset or a security entitlement, however framed, may not be brought against a person who purchases a security entitlement, or interest in it, from an entitlement holder if that purchaser,

(a) gives value;

(b) does not have notice of the adverse claim; and

(c) obtains control.

Same

(2) If a legal proceeding based on an adverse claim could not have been brought against an entitlement holder under section 96, a legal proceeding based on the adverse claim may not be brought against a person who purchases a security entitlement, or interest in it, from the entitlement holder.

Priority rules

(3) In a case not covered by the priority rules under the *Personal Property Security Act*, the following rules apply:

1. A purchaser for value of a security entitlement, or interest in it, who obtains control has priority over a purchaser of a security entitlement, or interest in it, who does not obtain control.

2. Except as otherwise provided in subsection (4), purchasers who have control rank according to priority in time of,

   i. the purchaser's becoming the person for whom the securities account in which the security entitlement is carried is maintained, if the purchaser obtained control under clause 25 (1) (a),

   ii. the securities intermediary's agreement to comply with the purchaser's entitlement orders with respect to

security entitlements carried or to be carried in the securities account in which the security entitlement is carried, if the purchaser obtained control under clause 25 (1) (b), or

iii. if the purchaser obtained control through another person under clause 25 (1) (c), the time on which priority would be based under this subsection if the other person were the purchaser.

Same

(4) A securities intermediary as purchaser has priority over a conflicting purchaser who has control unless otherwise agreed by the securities intermediary.

COMMENT

Source: UCC Rev 8-510

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-510. The drafting difference between STA s. 104(3) and Rev 8-510 (c)(3)—the STA uses "purchaser" where Rev 8 uses "secured party"—is intended to be a clarification, not a substantive difference.

1. This section specifies certain rules concerning the rights of persons who purchase interests in security entitlements from entitlement holders. The rules of this section are provided to take account of cases where the purchaser's rights are derivative from the rights of another person who is and continues to be the entitlement holder.

2. Subsection (1) provides that no adverse claim can be asserted against a purchaser of an interest in a security entitlement if the purchaser gives value, obtains control, and does not have notice of the adverse claim. The primary purpose of this rule is to give adverse claim protection to persons who take security interests in security entitlements and obtain control, but do not themselves become entitlement holders.

The following examples illustrate subsection (1):

Example 1. X steals a certificated bearer bond from Owner. X delivers the certificate to Able & Co. for credit to X's securities account. Later, X borrows from Bank and grants bank a security interest in the security entitlement. Bank obtains control under s. 25(1)(b) by virtue of an agreement in which Able agrees to comply with entitlement orders originated by Bank. X absconds.

Example 2. Same facts as in Example 1, except that Bank does not obtain a control agreement. Instead, Bank perfects by registering a financing statement in accordance with the relevant PPSA.

In both of these examples, when X deposited the bonds X acquired a security entitlement under s. 95. Under other law, Owner may be able to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that X misappropriated. X granted a security interest in that entitlement to Bank. Bank was a purchaser of an interest in the security entitlement from X. In Example 1, although Bank was not a person who acquired a security entitlement from the intermediary, Bank did obtain control. If Bank did not have notice of Owner's claim, s. 104(1) precludes Owner from asserting an adverse claim against Bank. In Example 2, Bank had a perfected security interest, but did not obtain control. Accordingly, s. 104(1) does not preclude Owner from asserting its adverse claim against Bank.

3. Subsection (2) applies to the indirect holding system a limited version of the "shelter principle". The following example illustrates the relatively limited class of cases for which it may be needed:

Example 3. Thief steals a certificated bearer bond from Owner. Thief delivers the certificate to Able & Co. for credit to Thief's securities account. Able forwards the certificate to a clearing agency for credit to Able's account. Later Thief instructs Able to sell the positions in the bonds. Able sells to Baker & Co., acting as broker for Buyer. The trade is settled by book-entries in the accounts of Able and Baker at the clearing agency, and in the accounts of Thief and Buyer at Able and Baker respectively. Owner may be able to reconstruct the trade records to show that settlement occurred in such fashion that the "same bonds" that were carried in Thief's account at Able are traceable into Buyer's account at Baker. Buyer later decides to donate the bonds to Alma Mater University and executes an assignment of its rights as entitlement holder to Alma Mater.

Buyer had a position in the bonds, which Buyer held in the form of a security entitlement against Baker. Buyer then made a gift of the position to Alma Mater. Although Alma Mater is a purchaser as defined in s. 1(1), it did not give value. Thus, Alma Mater is a person who purchased a security entitlement, or an interest therein, from an entitlement

holder (Buyer). Buyer was protected against Owner's adverse claim by s. 96. Thus, by virtue of s. 104(2), Owner is also precluded from asserting an adverse claim against Alma Mater.

4. Subsection (3) specifies a priority rule for cases where an entitlement holder transfers conflicting interests in the same security entitlement to different purchasers. It follows the same principle as the PPSA priority rule for investment property, that is, control trumps non-control. Indeed, the most significant category of conflicting "purchasers" may be secured parties. Priority questions for security interests, however, are governed by the rules in the PPSA. Subsection (3) applies only to cases not covered by the PPSA rules. It is intended primarily for disputes over conflicting claims arising out of repurchase agreement transactions that are not covered by the other rules set out in the STA and the PPSA.

The following example illustrates subsection (3):

Example 4. Dealer holds securities through an account at Alpha Bank. Alpha Bank in turns holds through a clearing agency account. Dealer transfers securities to RP1 in a "hold in custody" repo transaction. Dealer then transfers the same securities to RP2 in another repo transaction. The repo to RP2 is implemented by transferring the securities from Dealer's regular account at Alpha Bank to a special account maintained by Alpha Bank for Dealer and RP2. The agreement among Dealer, RP2, and Alpha Bank provides that Dealer can make substitutions for the securities but RP2 can direct Alpha Bank to sell any securities held in the special account. Dealer becomes insolvent. RP1 claims a prior interest in the securities transferred to RP2.

In this example Dealer remained the entitlement holder but agreed that RP2 could initiate entitlement orders to Dealer's securities intermediary, Alpha Bank. If RP2 had become the entitlement holder, the adverse claim rule of s. 96 would apply. Even if RP2 does not become the entitlement holder, the arrangement among Dealer, Alpha Bank, and RP2 does suffice to give RP2 control. Thus, under s. 104(3), RP2 has priority over RP1, because RP2 is a purchaser who obtained control, and RP1 is a purchaser who did not obtain control. The same result could be reached under s. 104(1) which provides that RP1's earlier in time interest cannot be asserted as an adverse claim against RP2. The same result would follow under the PPSA priority rules if the interests of RP1 and RP2 are characterized as "security interests," see PPSA s. 30.1(2). The main point of the rules of s. 104(3) is to ensure that there will be clear rules to cover the conflicting claims of RP1 and RP2 without characterizing their interests as security interests as defined by the PPSA.

The PPSA priority rules for conflicting security interests also include a default temporal priority rule for cases where multiple secured parties have obtained control but omitted to specify their respective rights by agreement. See PPSA s. 30.1(4). Because the purchaser priority rule in s. 104(3) is intended to track the PPSA priority rules, it too has a temporal priority rule for cases where multiple non-secured party purchasers have obtained control but omitted to specify their respective rights by agreement. The rule is patterned on PPSA s. 30.1(4).

5. If a securities intermediary itself is a purchaser, subsection (4) provides that it has priority over the interest of another purchaser who has control. The PPSA priority rules contain a similar provision. See PPSA s. 30.1(5).

Definitional cross-references:		
	"adverse claim"	s. 1(1)
	"control"	s. 1(1) and s. 25
	"entitlement holder"	s. 1(1)
	"notice of an adverse claim"	sections 18-22
	"purchase"	s. 1(1)
	"purchaser"	s. 1(1) and s. 55
	"secured party"	s. 1(1)
	"securities intermediary"	s. 1(1)
	"security entitlement"	s. 1(1)
	"security interest"	s. 1(1)
	"value"	s. 1(1) and s. 55

Priority of entitlement holders to financial asset

105. (1) Except as otherwise provided in subsections (2) and (3), if a securities intermediary does not have sufficient interests in a particular financial asset to satisfy both the securities intermediary's obligations to entitlement holders who have security entitlements to that financial asset and the securities intermediary's obligation to a creditor of the securities intermediary who has a security interest in that financial asset, the claims of entitlement holders, other than the creditor, have priority over the claim of the creditor.

When creditor has priority

(2) A claim of a creditor of a securities intermediary who has a security interest in a financial asset held by a securities intermediary has priority over claims of the securities intermediary's entitlement

holders who have security entitlements with respect to that financial asset if the creditor has control over the financial asset.

Same

(3) If a clearing agency does not have sufficient financial assets to satisfy both the clearing agency's obligations to entitlement holders who have security entitlements with respect to a financial asset and the clearing agency's obligation to a creditor of the clearing agency who has a security interest in that financial asset, the claim of the creditor has priority over the claims of entitlement holders.

COMMENT

Source: UCC Rev 8-511

Comparison with previous law: There is no comparable provision in existing Canadian law dealing with the indirect holding system.

Explanation: This provision is intended to be substantively uniform with the corresponding provisions of Rev 8-511.

1. This section sets out priority rules for circumstances in which a securities intermediary fails leaving an insufficient quantity of securities or other financial assets to satisfy the claims of its entitlement holders and the claims of creditors to whom it has granted security interests in financial assets held by it. Subsection (1) provides that entitlement holders' claims have priority except as otherwise provided in subsection (2), and subsection (2) provides that the secured creditor's claim has priority if the secured creditor obtains control. The following examples illustrate the operation of these rules.

Example 1. Able & Co., a broker, borrows from Alpha Bank and grants Alpha Bank a security interest pursuant to a written agreement which identifies certain securities that are to be collateral for the loan, either specifically or by category. Able holds these securities in an account with a clearing agency. Able becomes insolvent and it is discovered that Able holds insufficient securities to satisfy the claims of customers who have paid for securities that they held in accounts with Able and the collateral claims of Alpha Bank. Alpha Bank's security interest in the security entitlements that Able holds through the clearing agency account may be perfected under the automatic perfection rule of PPSA s. 19.2, but Alpha Bank did not obtain control as defined in s. 1(1). Thus, under s. 105(1) the entitlement holders' claims have priority over Alpha Bank's claim.

Example 2. Able & Co., a broker, borrows from Beta Bank and grants Beta Bank a security interest in securities that Able holds in an account with a clearing agency. Pursuant to the security agreement, the securities are debited from Able's account and credited to Beta's account with the clearing agency. Able becomes insolvent and it is discovered that Able holds insufficient securities to satisfy the claims of customers who have paid for securities that they held in accounts with Able and the collateral claims of Beta Bank. Although the transaction between Able and Beta took the form of an outright transfer on the clearing agency's books, as between Able and Beta, Able remains the owner and Beta has a security interest. In that respect the situation is no different than if Able had delivered bearer bonds to Beta in pledge to secure a loan. Beta's security interest is perfected, and Beta obtained control. See s. 25(1)(a) and s. 22.1. Under s. 105(2), Beta Bank's security interest has priority over claims of Able's customers.

The result in Example 2 is an application to this particular setting of the general principle expressed in s. 97, and explained in the Comments thereto, that the entitlement holders of a securities intermediary cannot assert rights against third parties to whom the intermediary has wrongfully transferred interests, except in extremely unusual circumstances where the third party was itself a participant in the transferor's wrongdoing. Under subsection (2) the claim of a secured creditor of a securities intermediary has priority over the claims of entitlement holders if the secured creditor has obtained control. If, however, the secured creditor acted in collusion with the intermediary in violating the intermediary's obligation to its entitlement holders, then under s. 97(4), the entitlement holders, through their representative in bankruptcy or insolvency proceedings, could recover the interest from the secured creditor, that is, set aside the security interest.

2. The risk that investors who hold through an intermediary will suffer a loss as a result of a wrongful pledge by the intermediary is no different than the risk that the intermediary might fail and not have the securities that it was supposed to be holding on behalf of its customers, either because the securities were never acquired by the intermediary or because the intermediary wrongfully sold securities that should have been kept to satisfy customers' claims. Investors are protected against that risk by the regulatory regimes under which securities intermediaries operate. For example, IDA By-Law 17 and Regulation 2000 provide that members of the IDA are required to segregate and hold in trust for their clients all fully paid or excess margin securities. The STA mirrors that requirement, specifying in s. 98 that a securities intermediary must maintain a sufficient quantity of investment property to satisfy all security entitlements, and may not grant security interests in the positions it is required to hold for customers, except as authorized by the customers.

If a failed brokerage has violated the customer protection regulations and does not have sufficient securities to satisfy customers' claims, its customers are usually protected against loss by the Canadian Investor Protection Fund (CIPF). CIPF is a not-for-profit corporation that operates in Canada as a compensation fund or contingency fund approved by certain provincial securities regulatory authorities pursuant to regulatory law. A CIPF member is a member of one or more of CIPF's sponsoring self-regulatory organizations: the IDA, the Bourse de Montréal Inc., the Toronto Stock Exchange and the TSX Venture Exchange (other than certain foreign member participants). Generally speaking, CIPF covers customer's losses of securities, cash balances and certain other property that result from the insolvency of a member, up to a coverage limit of $1 million per customer's general account. The Mutual Fund Dealers Association of Canada (MFDA) recently established the MFDA Investor Protection Corporation, which covers customer's losses of mutual fund securities and cash balances that result from the insolvency of a MFDA member up to a coverage limit of $1 million per customer account.

The STA is premised on the view that the important policy of protecting investors against the risk of wrongful conduct by their intermediaries is sufficiently treated by other law.

3. Subsection (3) sets out a special rule for secured financing provided to enable clearing agencies to complete settlement. In order to permit clearing agencies to establish liquidity facilities where necessary to ensure completion of settlement, subsection (3) provides a priority for secured lenders to such clearing agencies. Subsection (3) does not turn on control because the clearing agency may be the top tier securities intermediary for the securities pledged, so that there may be no practicable method for conferring control on the lender.

Definitional cross-references:	"clearing agency"	s. 1(1)
	"control"	s. 1(1)
	"entitlement holder"	s. 1(1)
	"securities intermediary"	s. 1(1)
	"security entitlement"	s. 1(1)
	"security interest"	s. 1(1)
	"value"	s. 1(1) and s. 55

PART 2

Commentary on *Personal Property Security Act* Amendments

See the Comments to the *Securities Transfer Act, 2006* (the "STA") for Comments in respect of terms used in the PPSA which are defined in the STA.

Definitions and interpretation

1. (1) In this Act, . . .

"account" means a monetary obligation not evidenced by chattel paper or an instrument, whether or not it has been earned by performance, but does not include investment property;

Source: UCC Rev 9-102(a)(2).

Comparison with previous law: See PPSA s. 1(1).

Explanation: The Report of the Working Group 2002-2003 to the Uniform Law Conference of Canada (available at:

http://www.chlc.ca/en/poam2/PPSA_Rep_2003_En.pdf)

(the "Working Group Report"), had recommended (at para. 52) the addition of the words "or a monetary obligation evidenced by investment property". Ultimately, those words were not added to the PPSA definition of "account" because that type of obligation is included within the definition of "investment property".

"clearing house" means an organization through which trades in options or standardized futures are cleared and settled;

"clearing house option" means an option, other than an option on futures, issued by a clearing house to its participants;

"futures account" means an account maintained by a futures intermediary in which a futures contract is carried for a futures customer;

"futures contract" means a standardized future or an option on futures, other than a clearing house option, that is,

(a) traded on or subject to the rules of a futures exchange recognized or otherwise regulated by the Ontario Securities Commission or by a securities regulatory authority of another province or territory of Canada, or

(b) traded on a foreign futures exchange and carried on the books of a futures intermediary for a futures customer;

"futures customer" means a person for which a futures intermediary carries a futures contract on its books;

"futures exchange" means an association or organization operated to provide the facilities necessary for the trading of standardized futures or options on futures;

"futures intermediary" means a person that,

(a) is registered as a dealer permitted to trade in futures contracts, whether as principal or agent, under the securities laws or commodity futures laws of a province or territory of Canada, or

(b) is a clearing house recognized or otherwise regulated by the Ontario Securities Commission or by a securities regulatory authority of another province or territory of Canada;

"investment property" means a security, whether certificated or uncertificated, security entitlement, securities account, futures contract or futures account;

COMMENT

Source: UCC Rev 9-102(a)(49).

Comparison with previous law: Not applicable.

Explanation: "Investment property" includes securities, both certificated and uncertificated, securities accounts, security entitlements, "futures contracts" and "futures accounts".

The term investment property includes a "securities account" in order to facilitate transactions in which a debtor wishes to create a security interest in all of the investment positions held through a particular account rather than in particular positions carried in the account.

The terms "security", "securities account" and "security entitlement" are defined in the STA. The terms "futures contracts" and "futures accounts", and the related terms "futures customer", "futures exchange", "futures intermediary", "clearing house", "clearing house option", "option", "option on futures" and "standardized future" are defined in this section.

Futures contracts are not "securities" or "financial assets" under the STA. See STA s. 16(1). Thus, the relationship between futures intermediaries and futures customers is not governed by the indirect-holding-system rules of the STA. For securities, the PPSA contains rules on security interests, and the STA contains rules on the rights of transferees, including secured parties, on such matters as the rights of a transferee if the transfer was itself wrongful and gives rise to an adverse claim. PPSA ss. 28(6) to 28(10) contain some additional rules applicable to transferees of securities and the acquisition of a security entitlement. For futures contracts, the PPSA establishes rules on security interests, but questions of the sort dealt with in the STA for securities are left to other law.

The indirect-holding-system rules of the STA are sufficiently flexible to be applied to new developments in the securities and financial markets, where that is appropriate. Accordingly, the definition of "futures contract" is narrowly drafted to ensure that it does not operate as an obstacle to the application of the STA indirect-holding-system rules to new products. The term "futures contract" covers those contracts that are traded on or subject to the rules of a designated futures exchange and those traded on a foreign futures exchange that are carried on the books of Canadian futures intermediaries. The effect of this definition is that the category of futures contracts that is excluded from the STA but governed by the PPSA is essentially the same as the category of futures contracts that fall within the exclusive regulatory jurisdiction of the Ontario Securities Commission or the securities regulatory authority of another province or territory of Canada.

Futures contracts are different from securities or other financial assets. A person who enters into a futures contract is not buying an asset having a certain value and holding it in anticipation of increase in value. Rather the person is entering into a contract to buy or sell a commodity at set price for delivery at a future time. That contract may become advantageous or disadvantageous as the price of the commodity fluctuates during the term of the contract. The rules of the futures exchanges require that the contracts be marked to market on a daily basis; that is, the customer pays or receives any increment attributable to that day's price change. Because futures customers may incur obligations on their contracts, they are required to provide collateral at the outset, known as "original margin", and may be required to provide additional amounts, known as "variation margin", during the term of the contract.

The most likely setting in which a person would want to take a security interest in a futures contract is where a lender who is advancing funds to finance an inventory of a physical commodity requires the borrower to enter into a futures contract as a hedge against the risk of decline in the value of the commodity. The lender will want to take a security interest in both the commodity itself and the hedging futures contract. Typically, such arrangements are structured as security interests in the entire futures account in which the borrower carries the hedging contracts, rather than in individual contracts.

One important effect of including futures contracts and futures accounts in the PPSA is to provide a clearer legal structure for the analysis of the rights of clearing houses against their participants and futures dealers against their customers. The rules and agreements of clearing houses generally provide that the clearing house has the right to liquidate any participant's positions in order to satisfy obligations of the participant to the clearing house. Similarly, agreements between futures dealers and their customers generally provide that the futures dealer has the right to liquidate a

customer's positions in order to satisfy obligations of the customer to the futures dealer.

The main property that a futures intermediary holds as collateral for the obligations that the futures customer may incur under its futures contracts is not other futures contracts carried by the customer but the other property that the customer has posted as margin. Typically, this property will be securities. The futures intermediary's security interest in such securities is governed by the rules of the PPSA on security interests in investment property, not the rules on security interests in futures contracts or futures accounts.

Although there are significant analytic and regulatory differences between futures and securities, the development of futures contracts on financial products in the past few decades has resulted in a system in which the futures markets and securities markets are closely linked. The rules on security interests in futures contracts and futures accounts provide a structure that may be essential in times of stress in the financial markets. Suppose, for example that a firm has a position in a securities market that is hedged by a position in a futures market, so that payments that the firm is obligated to make with respect to the securities position will be covered by the receipt of funds from the futures position. Depending upon the settlement cycles of the different markets, it is possible that the firm could find itself in a position where it is obligated to make the payment with respect to the securities position before it receives the matching funds from the futures position. If cross-margining arrangements have not been developed between the two markets, the firm may need to borrow funds temporarily to make the earlier payment. The rules on security interests in investment property would facilitate the use of positions in one market as collateral for loans needed to cover obligations in the other market.

"option" means an agreement that provides the holder with the right, but not the obligation, to do one or more of the following on terms or at a price established by or determinable by reference to the agreement at or by a time established by the agreement:

1. Receive an amount of cash determinable by reference to a specified quantity of the underlying interest of the option.
2. Purchase a specified quantity of the underlying interest of the option.
3. Sell a specified quantity of the underlying interest of the option.

"option on futures" means an option the underlying interest of which is a standardized future;

"proceeds" means identifiable or traceable personal property in any form derived directly or indirectly from any dealing with collateral or the proceeds therefrom, and includes,

(a) any payment representing indemnity or compensation for loss of or damage to the collateral or proceeds therefrom,

(b) any payment made in total or partial discharge or redemption of an intangible, chattel paper, an instrument or investment property, and

(c) rights arising out of, or property collected on, or distributed on account of, collateral that is investment property;

Source: UCC Rev 9-102(a)(64).

Comparison with previous law: PPSA s. 1(1).

Explanation: The definition of "proceeds" was revised to clarify that payments made to discharge or redeem various obligations, or other rights or property arising from, or collected or distributed on investment property are included in the definition of "proceeds". This change makes it clear that dividends (in cash or in kind) and interest are regarded as "proceeds".

"purchase-money security interest" means,

(a) a security interest taken or reserved in collateral, other than investment property, to secure payment of all or part of its price, or

(b) a security interest taken in collateral, other than investment property, by a person who gives value for the purpose of enabling the debtor to acquire rights in or to the collateral, to the extent that the value is applied to acquire the rights;

Source: UCC Rev 9-103 (limiting purchase-money collateral to goods and software).

Comparison with previous law: PPSA s. 1(1).

Explanation: "Investment property" is excluded from the definition of "purchase-money security interest" because the control priority rules of each of PPSA ss. 30.1(2) and 30.1(5) provide for the ordinary cases in which persons purchase securities on margin credit from their brokers. As a consequence, there is no need for special priority rules for purchase-money security interests in investment property. The revised definition of "purchase-money security interest" inadvertently omits the words (appearing as a concluding clause of the definition before amendment on January 1, 2007) stating "but does not include a transaction of sale and lease back to the seller".

"standardized future" means an agreement traded on a futures exchange pursuant to standardized conditions contained in the by-laws, rules or regulations of the futures exchange, and cleared and settled by a clearing house, to do one or more of the following at a price established by or determinable by reference to the agreement and at or by a time established by or determinable by reference to the agreement:

1. Make or take delivery of the underlying interest of the agreement.

2. Settle the obligation in cash instead of delivery of the underlying interest.

Determination of control

(2) For the purposes of this Act,

(a) a secured party has control of a certificated security if the secured party has control in the manner provided under section 23 of the *Securities Transfer Act, 2006*;

(b) a secured party has control of an uncertificated security if the secured party has control in the manner provided under section 24 of the *Securities Transfer Act, 2006*;

(c) a secured party has control of a security entitlement if the secured party has control in the manner provided under section 25 or 26 of the *Securities Transfer Act, 2006*;

(d) a secured party has control of a futures contract if,

(i) the secured party is the futures intermediary with which the futures contract is carried, or

(ii) the futures customer, secured party and futures intermediary have agreed that the futures intermediary will apply any value distributed on account of the futures contract as directed by the secured party without further consent by the futures customer; and

(e) a secured party having control of all security entitlements or futures contracts carried in a securities account or futures account has control over the securities account or futures account.

Source: UCC Rev 9-106.

Comparison with previous law: Not applicable.

Explanation:

1. "Control" Under the STA. For an explanation of "control" of securities and certain other investment property, see STA ss. 23 to 26 and the related Comments.

2. "Control" of Futures Contracts. This section contains provisions relating to

control of futures contracts which are analogous to those in STA ss. 25 and 26 for other types of investment property.

3. Securities Accounts and Futures Accounts. For drafting convenience, control with respect to a securities account or futures account is defined in terms of obtaining control over the security entitlements or futures contracts carried in the account. Of course, an agreement that provides that (without further consent of the debtor) the securities intermediary or futures intermediary will comply with instructions from the secured party concerning a securities account or futures account described as such is sufficient. Such an agreement necessarily implies that the intermediary will comply with instructions concerning all security entitlements or futures contracts carried in the account and thus affords the secured party control of all the security entitlements or futures contracts.

Non-application of Act

4. (1) Except as otherwise provided under this Act, this Act does not apply,

. . .

(c) to a transfer of an interest or claim in or under any policy of insurance or contract of annuity, other than a contract of annuity held by a securities intermediary for another person in a securities account;

Source: New.

Comparison with previous law: PPSA s. 4(1)(c).

Explanation: The Working Group Report noted (at para. 58) that Canadian insurance companies are considering issuing annuities in a way comparable to the practice of U.S. companies. Even if they are not traded, these will fall within the definition of financial asset in STA s. 1(1) because they represent an obligation that is recognized as a medium for investment within the meaning of clause (b)(ii) of the definition of "financial asset" in STA s. 1(1). Annuities issued in favour of a securities intermediary (such as the nominee of CDS Clearing and Depository Services Inc.) would fall within the indirect holding system under the STA. If the previous exclusion of a transfer of an interest or claim in or under any contract of annuity under the PPSA were allowed to persist, it would have raised a barrier against taking a security interest in indirectly held annuities.

Conflict of laws – validity of security interest in investment property

7.1 (1) The validity of a security interest in investment property shall be governed by the law, at the time the security interest attaches,

(a) of the jurisdiction where the certificate is located if the collateral is a certificated security;

(b) of the issuer's jurisdiction if the collateral is an uncertificated security;

(c) of the securities intermediary's jurisdiction if the collateral is a security entitlement or a securities account;

(d) of the futures intermediary's jurisdiction if the collateral is a futures contract or a futures account.

Same

(2) Except as otherwise provided in subsection (5), perfection, the effect of perfection or of nonperfection and the priority of a security interest in investment property shall be governed by the law,

(a) of the jurisdiction in which the certificate is located if the collateral is a certificated security;

(b) of the issuer's jurisdiction if the collateral is an uncertificated security;

(c) of the securities intermediary's jurisdiction if the collateral is a security entitlement or a securities account;

(d) of the futures intermediary's jurisdiction if the collateral is a futures contract or a futures account.

Determination of jurisdiction

(3) For the purposes of this section,

(a) the location of the debtor is determined by subsection 7 (3);

(b) the issuer's jurisdiction is determined under section 44 of the *Securities Transfer Act, 2006*;

(c) the securities intermediary's jurisdiction is determined under section 45 of the *Securities Transfer Act, 2006*.

Same

(4) For the purposes of this section, the following rules determine a futures intermediary's jurisdiction:

1. If an agreement between the futures intermediary and futures customer governing the futures account expressly provides that a particular jurisdiction is the futures intermediary's jurisdiction for purposes of the law of that jurisdiction, this Act or any provision of this Act, the jurisdiction expressly provided for in the agreement is the futures intermediary's jurisdiction.

2. If paragraph 1 does not apply and an agreement between the futures intermediary and futures customer governing the futures account expressly provides that the agreement shall be governed by the law of a particular jurisdiction, that jurisdiction is the futures intermediary's jurisdiction.

3. If neither paragraph 1 nor 2 applies and an agreement between the futures intermediary and futures customer governing the futures account expressly provides that the futures account is maintained at an office in a particular jurisdiction, that jurisdiction is the futures intermediary's jurisdiction.

4. If none of the preceding paragraphs applies, the futures intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the futures customer's account is located.

5. If none of the preceding paragraphs applies, the futures intermediary's jurisdiction is the jurisdiction in which the chief executive office of the futures intermediary is located.

Matters governed by law of debtor's jurisdiction

(5) The law of the jurisdiction in which the debtor is located governs,

(a) perfection of a security interest in investment property by registration;

(b) perfection of a security interest in investment property granted by a broker or securities intermediary where the secured party relies on attachment of the security interest as perfection; and

(c) perfection of a security interest in a futures contract or futures account granted by a futures intermediary where the secured party relies on attachment of the security interest as perfection.

Perfection of security interest

(6) A security interest perfected pursuant to the law of the jurisdiction designated in subsection (5) remains perfected until the earliest of,

(a) 60 days after the day the debtor relocates to another jurisdiction;

(b) 15 days after the day the secured party knows the debtor has relocated to another jurisdiction; and

(c) the day that perfection ceases under the previously applicable law.

Same

(7) A security interest in investment property which is perfected under the law of the issuer's jurisdiction, the securities intermediary's jurisdiction or the futures intermediary's jurisdiction, as applicable, remains perfected until the earliest of,

(a) 60 days after a change of the applicable jurisdiction to another jurisdiction;

(b) 15 days after the day the secured party knows of the change of the applicable jurisdiction to another jurisdiction; and

(c) the day that perfection ceases under the previously applicable law.

Source: In part, UCC Rev 9-305.

Comparison with previous law: PPSA s. 5(1).

Explanation:

1. Validity. According to the Working Group Report (at para. 78), section 7.1(1) extends the choice of law rules on the proprietary effects of various categories of investment property (as set forth in STA ss. 44 to 46) to the issue of the initial validity of a security interest, with the exception that the law governing validity does not change even when the connecting factor changes.

2. Perfection and Priority. Section 7.1(2) specifies choice-of-law rules for perfection and priority of security interests in investment property. Unlike sections 5 and 7, sections 7.1(1) and 7.1(2) separate the choice of law rules governing the validity of a security interest in investment property from those governing perfection, effect of perfection or non-perfection and priority. The rules in s. 7.1(1) about validity of a security interest apply only to the circumstances existing at the time of attachment. The rules in s. 7.1(2) about perfection, effect of perfection or non-perfection and priority apply at the time those issues are to be determined.

3. Determining the Jurisdiction. The approach of sections 7.1(1) to 7.1(4) is consistent with the principles that the STA uses to determine other questions concerning the forms of investment property addressed by those sections. Thus, for certificated securities, the law of the jurisdiction in which the certificate is located governs. *Cf.* STA s. 46. For uncertificated securities, the law of the issuer's jurisdiction governs. *Cf.* STA s. 44(2). For security entitlements and securities accounts, the law of the securities intermediary's jurisdiction governs. *Cf.* STA s. 45. For futures contracts and futures accounts, the law of the futures intermediary's jurisdiction governs. Because futures contracts and futures accounts are not governed by the STA, PPSA s. 7.1(4) contains rules that specify the futures intermediary's jurisdiction. These are analogous to the rules in STA s. 45(2) specifying a securities intermediary's jurisdiction.

4. Exceptions. Section 7.1(5) establishes an exception to the general choice-of-law rules for perfection (but not priority) set out in section 7.1(2). Section 7.1(5) provides that perfection of a security interest by registration, automatic perfection of a security interest in investment property created by a debtor who is a broker or securities intermediary (see PPSA s. 19.2(2)), and automatic perfection of a security interest in a futures contract or futures account of a debtor who is a futures intermediary (see PPSA s. 19.2(3)) are governed by the law of the jurisdiction in which the debtor is located, as determined under PPSA s. 7(3) (see also PPSA s. 7.1(3)(a)). As with UCC Rev 9-305(c), these exceptions are limited to the choice-of-law rules for perfection, and do not apply to the choice-of-law rules for priority. This difference

reflects the proposition that choice-of-law rules should point to a single jurisdiction to determine the priority of conflicting security interests, even where those rules recognize that the laws of different jurisdictions can be applied to determine the perfection (and obviously, the validity) of competing security interests.

5. Examples: The following examples illustrate the rules in this section:

Example 1: A customer residing in Ontario maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by British Columbia law but expressly provides that the law of Alberta is Able's jurisdiction for purposes of the STA. Through the account the customer holds securities of a Quebec corporation, which Able holds through a clearing agency located in Ontario. The customer obtains a margin loan from Able. Sections 7.1(1)(c) and 7.1(2)(c) provide that Alberta law -- the law of the securities intermediary's jurisdiction -- governs the validity and the perfection and priority of the security interest, even if Alberta law has no other relationship to the parties or the transaction. While that conclusion would be clear if litigation about those questions takes place in Ontario, a different conclusion could be reached if litigation takes place in another jurisdiction because a court in that other jurisdiction would apply its own choice-of-law rules. Therefore, a lender would be well advised to ensure that all steps have been taken to protect its interests in each jurisdiction in which litigation about its security interest could reasonably be expected to arise. As more jurisdictions in Canada adopt the STA, the possibility of different conclusions will be diminished.

Example 2: A customer residing in Ontario maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Alberta law. Through the account the customer holds securities of a Quebec corporation, which Able holds through a clearing agency located in Ontario. The customer obtains a loan from a lender located in British Columbia. The lender takes a security interest and perfects by obtaining an agreement among the debtor, itself, and Able, which satisfies the requirement of STA s. 25(1)(b) to give the lender control. PPSA s. 7.1(2)(c) provides that Alberta law -- the law of the securities intermediary's jurisdiction -- governs the perfection and priority of the security interest, even if Alberta has no other relationship to the parties or the transaction. As noted in Example 1 above, a lender would be well advised to ensure that all steps have been taken to protect its interests in each jurisdiction in which litigation about its security interest could reasonably be expected to arise.

Example 3: A customer residing in Ontario maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Alberta law. Through the account, the customer holds securities of a Quebec corporation, which Able holds through a clearing corporation located in Ontario. The customer borrows from SP-1, and SP-1 registers a financing statement

in Ontario. Later, the customer obtains a loan from SP-2. SP-2 takes a security interest and perfects by obtaining an agreement among the debtor, itself, and Able, which satisfies the requirement of STA s. 25(1)(b) to give SP-2 control. Section 7.1(5) provides that perfection of SP-1's security interest by registration is governed by the location of the debtor, so the registration in Ontario was appropriate. Section 7.1(2)(c), however, provides that Alberta law -- the law of the securities intermediary's jurisdiction -- governs all perfection and priority. Thus, Alberta law governs perfection of SP-2's security interest, and Alberta law also governs the priority of the security interests of SP-1 and SP-2. As noted in Example 1 above, a lender would be well advised to ensure that all steps have been taken to protect its interests in each jurisdiction in which litigation about its security interest could reasonably be expected to arise.

6. Change in Law Governing Perfection. When the issuer's jurisdiction, the securities intermediary's jurisdiction, or the futures intermediary's jurisdiction changes, the jurisdiction whose law governs perfection under section 7.1(2) changes, as well. Similarly, the law governing perfection of a security interest in a certificated security perfected by delivery or control changes when the security certificate is removed to another jurisdiction -- see section 7.1(2)(a) -- and the law governing perfection by registration changes when the debtor changes its location -- see section 7.1(5). Nevertheless, these changes in the issuer's jurisdiction, the securities intermediary's jurisdiction, or the futures intermediary's jurisdiction will not result in an immediate loss of perfection -- see section 7.1(7). As noted by the Working Group Report (at paras. 81 to 82 and 85), the time periods set forth in sections 7.1(6) and 7.1(7) are consistent with the PPSA rules applicable to other categories of collateral -- see PPSA section 5(2). As further noted by the Working Group Report (at para. 83), the rules allowing for a temporary period of continuing perfection upon relocation of a debtor address only the relocation to Ontario. This approach will ensure that the consequences of relocation to any particular jurisdiction are governed by the equivalent provision in the secured transactions law of that jurisdiction. So, for example, if a debtor relocates to Ontario from Quebec, Quebec law will decide the period of automatic continuing perfection. This approach will avoid a conflict in the event that different jurisdictions adopt different grace periods for temporary continuing perfection. In those situations, the law of the jurisdiction in which the debtor is located should be paramount, and this is the effect of section 7.1(7). The rules in section 7.1(7) do not apply to the relocation of a security certificate. Therefore, if the security certificate is relocated from one jurisdiction to another, section 7.1(2)(a) dictates that perfection, the effect of perfection or non-perfection and the priority of a security interest are immediately governed by the laws of the new jurisdiction.

Interpretation – law of jurisdiction

8.1 For the purposes of sections 5 to 8, a reference to the law of a jurisdiction is a reference to the internal law of that jurisdiction, excluding its conflict of law rules.

Source: Working Group Report (para. 88).

Comparison with previous law: Not applicable.

Explanation: This provision rejects the applicability of the doctrine of renvoi.

Attachment required to enforce security interest

11. (1) A security interest is not enforceable against a third party unless it has attached.

When security interest attaches to collateral

(2) Subject to section 11.1, a security interest, including a security interest in the nature of a floating charge, attaches to collateral only when value is given, the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party and,

(a) the debtor has signed a security agreement that contains,

(i) a description of the collateral sufficient to enable it to be identified, or

(ii) a description of collateral that is a security entitlement, securities account or futures account, if it describes the collateral by any of those terms or as investment property or if it describes the underlying financial asset or futures contract;

(b) the collateral is not a certificated security and is in the possession of the secured party or a person on behalf of the secured party other than the debtor or the debtor's agent pursuant to the debtor's security agreement;

(c) the collateral is a certificated security in registered form and the security certificate has been delivered to the secured party under section 68 of the *Securities Transfer Act, 2006* pursuant to the debtor's security agreement; or

(d) the collateral is investment property and the secured party has control under subsection 1 (2) pursuant to the debtor's security agreement.

Same

(3) If the parties have agreed to postpone the time for attachment, the security interest attaches at the agreed time instead of at the time determined under subsection (2).

Attachment in securities account

(4) The attachment of a security interest in a securities account is also attachment of a security interest in the security entitlements carried in the securities account.

Attachment in futures account

(5) The attachment of a security interest in a futures account is also attachment of a security interest in the futures contracts carried in the futures account.

Source: UCC Rev 9-108 and 9-203.

Comparison with previous law: PPSA ss. 11(1) - 11(2).

Explanation:

1. Attachment. Section 11(2) sets out the three basic elements of attachment: value, rights or power to transfer rights in collateral (paragraph (2)), and a security agreement plus satisfaction of an evidentiary requirement. When all of these elements exist, a security interest is enforceable against third parties under section 11(1), subject to the possibility that third parties may acquire rights ranking in priority to the secured party or which cut off claims by the secured party. Section 11.1 sets forth some additional rules for automatic attachment.

2. Value. Section 1(1) defines "value" as " means any consideration sufficient to support a simple contract and includes an antecedent debt or liability".

3. Debtor's Rights; Debtor's Power to Transfer Rights. As a necessary element of attachment, section 11(2) requires that a debtor have "rights in the collateral or the power to transfer rights in the collateral to a secured party". A debtor's limited rights in collateral, short of full ownership, are sufficient for a security interest to attach. However, in accordance with basic personal property conveyancing principles, the baseline rule is that a security interest attaches only to whatever rights a debtor may have, broad or limited as those rights may be.

Certain exceptions to the baseline rule enable a debtor to transfer, and a security interest to attach to, greater rights than the debtor has. (*e.g.*, the rights of a "protected purchaser" under STA s. 70). The phrase, "or the power to transfer rights in the collateral to a secured party" accommodates exceptions of that type.

4. Signed Security Agreement. Under section 11(2)(a), the evidentiary requirement consists of the debtor signing a security agreement which describes the collateral. Section 11(2)(a)(i) merely requires a description of collateral sufficient to enable it to be identified. The purpose of requiring a description of collateral in a security agreement is evidentiary. The test of sufficiency of a description under this section is that the description do the job assigned to it: make possible the identification of the collateral described. The section rejects any argument that a description is insufficient unless it is exact and detailed (the so-called "serial number"

test). Under section 11(2)(a)(ii), the use of the wrong STA terminology does not render a description invalid (*e.g.*, a security agreement intended to cover a debtor's "security entitlements" is sufficient if it refers to the debtor's "securities"). Note also that given the broad definition of "securities account" in STA s. 1(1), a security interest in a securities account also includes all other rights of the debtor against the securities intermediary arising out of the securities account. For example, a security interest in a securities account would include credit balances due to the debtor from the securities intermediary, whether or not they are proceeds of a security entitlement. Moreover, describing collateral as a securities account is a simple way of describing all of the security entitlements carried in the account.

5. Possession, Delivery, or Control Pursuant to Security Agreement. The other alternatives in sections 11(2)(b), 11(2)(c) and 11(2)(d) dispense with the requirement of a signed security agreement and provide alternative evidentiary tests. Under section 11(2)(b), for collateral other than a certificated security, the secured party's possession substitutes for the debtor signing a security agreement under paragraph section 11(2)(a) if the secured party's possession is "pursuant to the debtor's security agreement". That phrase refers to the debtor's agreement to the secured party's possession for the purpose of creating a security interest. In the unlikely event that possession is obtained without the debtor's agreement, possession would not suffice as a substitute for a signed security agreement. However, once the security interest has become enforceable and has attached, it is not impaired by the fact that the secured party's possession is maintained without the agreement of a subsequent debtor (*e.g.*, a transferee). Consistent with section 22(1), the debtor or the debtor's agent possess the collateral on behalf of the secured party for the purposes of section 11(2)(b). Section 11(2)(c) provides that delivery of a certificated security to the secured party under STA s. 68 pursuant to the debtor's security agreement is sufficient as a substitute for a signed security agreement. Similarly, under section 11(2)(d), control of investment property satisfies the evidentiary test if control is pursuant to the debtor's security agreement.

6. Investment Property. Sections 11(4) and 11(5) make clear that attachment of a security interest in a securities account or a futures account is also attachment of a security interest in the security entitlements or futures contracts carried in the accounts.

Attachment of security interest to security entitlement

11.1 (1) A security interest in favour of a securities intermediary attaches to a person's security entitlement if,

(a) the person buys a financial asset through the securities intermediary in a transaction in which the person is obligated to pay the purchase price to the securities intermediary at the time of the purchase; and

(b) the securities intermediary credits the financial asset to the buyer's securities account before the buyer pays the securities intermediary.

Attachment of security interest to security or other financial asset

(2) A security interest in favour of a person that delivers a certificated security or other financial asset represented by a writing attaches to the security or other financial asset if,

(a) the security or other financial asset is,

(i) in the ordinary course of business transferred by delivery with any necessary endorsement or assignment, and

(ii) delivered under an agreement between persons in the business of dealing with such securities or financial assets; and

(b) the agreement calls for delivery against payment.

Agreement

(3) If the parties have agreed to postpone the time for attachment, the security interest attaches at the agreed time instead of at the time determined under subsection (1) or (2).

Obligation to pay for financial asset secured

(4) The security interest described in subsection (1) secures the person's obligation to pay for the financial asset.

Obligation to pay for delivery secured

(5) The security interest described in subsection (2) secures the obligation to make payment for the delivery.

Source: UCC Rev 9-206.

Comparison with previous law: Not applicable.

Explanation:

1. Codification of "Broker's Lien". Depending upon a securities intermediary's arrangements with its entitlement holders, the securities intermediary may treat the entitlement holder as entitled to financial assets before the entitlement holder has actually made payment for them. For example, brokers may permit retail customers to pay for financial assets by cheque. The broker may not receive final payment of the cheque until several days after the broker has credited the customer's securities account for the financial assets. Thus, the customer will have acquired a security

entitlement prior to payment. Section 11.1(1) provides that, in such circumstances, the securities intermediary has a security interest in the entitlement holder's security entitlement. Under section 11.1(4) the security interest secures the customer's obligation to pay for the financial asset in question. Sections 11.1(1) and 11.1(4) codify and adapt to the indirect holding system the so-called "broker's lien" which has long been recognized. See *Jones v. Davidson Partners Ltd.* (1981), 31 O.R. (2d) 494 (H.C.).

2. Financial Assets Delivered Against Payment. Section 11.1(2) creates a security interest in favour of persons who deliver certificated securities or other financial assets in physical form, such as money market instruments, if the agreed payment is not received. In some arrangements for settlement of transactions in physical financial assets, the seller's securities custodian will deliver physical certificates to the buyer's securities custodian and receive a time-stamped delivery receipt. The buyer's securities custodian will examine the certificate to ensure that it is in good order, and that the delivery matches a trade in which the buyer has instructed the seller to deliver to that custodian. If all is in order, the receiving custodian will settle with the delivering custodian through whatever funds settlement system has been agreed upon or is used by custom and usage in that market. The understanding of the trade, however, is that the delivery is conditioned upon payment, so that if payment is not made for any reason, the security will be returned to the deliverer. Section 11.1(2) clarifies the rights of persons making deliveries in such circumstances. It provides the person making delivery with a security interest in the securities or other financial assets. Under section 11.1(5), the security interest secures the seller's right to receive payment for the delivery. STA s. 68(1) specifies when delivery of a certificated security occurs; that section should be applied as well to other financial assets as well for purposes of this section.

3. Agreement to Postpone Attachment. Section 11.1(3) recognizes that parties may agree to postpone the time for attachment of the security interest created by section 11.1(1) or 11.1(2).

4. Automatic Attachment and Perfection. Sections 11.1(1) and 11.1(2) refer to attachment of a security interest. Attachment under this section has the same incidents (enforceability, right to proceeds, *etc.*) as attachment under section 11. This section overrides the general attachment rules in 11(2), which is expressed to be subject to section 11.1. A securities intermediary's security interest under section 11.1(1) is perfected by control without further action. See STA s. 26 (control); PPSA s. 22.1(1) (perfection). Security interests arising under section 11.1(2) are automatically perfected. See PPSA s. 19.2(1).

Rights of secured party with control of investment property as collateral

17.1 (1) Unless otherwise agreed by the parties and despite section 17, a secured party having control under subsection 1(2) of investment property as collateral,

(a) may hold as additional security any proceeds received from the collateral;

(b) shall either apply money or funds received from the collateral to reduce the secured obligation or remit such money or funds to the debtor; and

(c) may create a security interest in the collateral.

Same

(2) Despite subsection (1) and section 17, a secured party having control under subsection 1 (2) of investment property as collateral may sell, transfer, use or otherwise deal with the collateral in the manner and to the extent provided in the security agreement.

Source: UCC Rev 9-207, except for s. 17.1(2) which has no counterpart in UCC Rev 9.

Comparison with previous law: PPSA s. 17.

Explanation:

1. Applicability Following Default. The rules in section 17.1 apply in addition to section 17, but override section 17 in the case of conflict. Sections 17 and 17.1 apply when the secured party has control of collateral either before or after default. See PPSA ss. 59(1) and 62. Section 59(5) provides that a debtor cannot waive or vary the debtor's rights or the secured party's duties under sections 17 or 17.1 except as provided by the PPSA.

2. "Repledges" and Right of Redemption. Section 17.1(1)(c) eliminates the qualification under section 17(2)(e) to the effect that the terms of a "repledge" may not "impair" a debtor's "right to redeem" collateral. The change is primarily for clarification, and to ensure that the PPSA is consistent with market practices for investment property. See Working Group Report (at para. 95). There is no basis on which to draw from section 17.1(1)(c) any inference concerning the debtor's right to redeem the collateral. The debtor enjoys that right under PPSA s. 66(1); this section need not address it. For example, if the collateral is a negotiable note that SP-1 repledges to SP-2, nothing in this section suggests that the debtor (D) does not retain the right to redeem the note upon payment to SP-1 of all obligations secured by the note. But, as explained below, the debtor's unimpaired right to redeem as against the debtor's original secured party (SP-1) nevertheless may not be enforceable as against the new secured party (SP-2).

In resolving questions that arise from the creation of a security interest by SP-1, one must take care to distinguish D's rights against SP-1 from D's rights against SP-2.

Once D discharges the secured obligation, D becomes entitled to the note; SP-1 has no legal basis upon which to withhold it. If, as a practical matter, SP-1 is unable to return the note because SP-2 holds it as collateral for SP-1's unpaid debt, then SP-1 is liable to D under the law of conversion.

Whether SP-2 would be liable to D depends on the relative priority of SP-2's security interest and D's interest. By permitting SP-1 to create a security interest in the collateral (repledge), section 17.1(1)(c) provides a statutory power for SP-1 to give SP-2 a security interest (subject, of course, to any agreement by SP-1 not to give a security interest). In the vast majority of cases where repledge rights are significant, the security interest of the second secured party, SP-2 in the example, will be senior to the debtor's interest. By virtue of the debtor's consent or applicable legal rules, SP-2 typically would cut off D's rights in investment property or be immune from D's claims. See PPSA s. 29(a) (holder in due course), STA s. 70 (protected purchaser), STA s. 96 (protection of entitlement holders from adverse claims), STA s. 97(4) (action by entitlement holder). Moreover, the expectations and business practices in some markets, such as the securities markets, are such that D's consent to SP-2's taking free of D's rights inheres in D's creation of SP-1's security interest which gives rise to SP-1's power under this section. In these situations, D would have no right to recover the collateral or recover damages from SP-2. Nevertheless, D would have a damage claim against SP-1 if SP-1 had given a security interest to SP-2 in breach of its agreement with D. Moreover, if SP-2's security interest secures an amount that is less than the amount secured by SP-1's security interest (granted by D), then D's exercise of its right to redeem would provide value sufficient to discharge SP-1's obligations to SP-2.

For the most part Section 17.1(1) does not change the law under former section 17(2)(e) as it applied to securities and other investment property, although eliminating the reference to the debtor's right of redemption may alter the secured party's right to repledge in one respect. Section 17(1)(2)(e) could have been read to limit the secured party's statutory right to repledge collateral to repledge transactions in which the collateral did not secure a greater obligation than that of the original debtor. Inasmuch as this is a matter normally dealt with by agreement between the debtor and secured party, any change would appear to have little practical effect.

3. Rights of "Reuse". Section 17.1(2), which has no counterpart in UCC Rev 9, resolves a long-standing debate about whether under former section 17(2)(e) it was permissible for a secured party to use or even sell securities that it held as collateral, even with the debtor's prior agreement, because so doing would arguably impair the debtor's non-waivable right to redeem the collateral. There was therefore no firm statutory basis to support the existing market practices for collateralized derivatives, securities lending and repurchase and reverse repurchase transactions which often demanded that the secured party have "re-use" rights entitling it to use or even sell

fungible securities held as collateral. Section 17.1(2) now clearly permits a secured party having control of investment property as collateral to sell, transfer, use or otherwise deal with the investment property collateral in the manner and to the extent provided in the security agreement. As with "repledges", such re-use rights do not in themselves affect the debtor's right to redeem the collateral. In addition, by virtue of section 22.1(2), the secured party's security interest in investment property of which it has control and which it subsequently transfers or sells will not necessarily become unperfected by reason of the consequent loss of control so long as the debtor does not re-acquire control: see the final sentence of the Comment on section 22.1.

4. Example. The following example will illustrate the application of the new rules relating to "repledges" and "re-use" of investment property:

Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. that Debtor holds through an account with Able & Co. Alpha does not have an account with Able. Alpha uses Beta Bank as its securities custodian. Debtor instructs Able to transfer the shares to Beta, for the account of Alpha, and Able does so. Beta then credits Alpha's account. Alpha has control of the security entitlement for the 1000 shares under STA s. 25(1)(a). (These are the facts of Example 2, STA s. 25(1)(a).) Although, as between Debtor and Alpha, Debtor may have become the beneficial owner of the new security entitlement with Beta, Beta has agreed to act on Alpha's entitlement orders because, as between Beta and Alpha, Alpha has become the entitlement holder.

Next, Alpha grants Gamma Bank a security interest in the security entitlement with Beta that includes the 1000 shares of XYZ Co. In order to afford Gamma control of the entitlement, Alpha instructs Beta to transfer the shares to Gamma's custodian, Delta Bank, which credits Gamma's account for 1000 shares. At this point Gamma holds its security entitlement for its benefit as well as that of its debtor, Alpha. Alpha's derivative rights also are for the benefit of Debtor.

In many, probably most, situations and at any particular point in time, it will be impossible for Debtor or Alpha to "trace" Alpha's "repledge" to any particular security entitlement or financial asset of Gamma or anyone else. Debtor would retain, of course, a right to redeem the collateral from Alpha upon satisfaction of the secured obligation. However, in the absence of a traceable interest, Debtor would retain only a personal claim against Alpha in the event Alpha failed to restore the security entitlement to Debtor. Moreover, even in the unlikely event that Debtor could trace a property interest, in the context of the financial markets, normally the operation of this section, Debtor's explicit agreement to permit Alpha to create a senior security interest, or legal rules permitting Gamma to cut off Debtor's rights or become immune from Debtor's claims would effectively subordinate Debtor's interest to the holder of a security interest created by Alpha. As well, under the shelter principle, all

subsequent transferees would obtain interests to which Debtor's interest also would be subordinate. The same principles would apply if instead of granting Gamma Bank a security interest in the security entitlement with Beta, Alpha sold the 1000 shares to Gamma Bank in a "repo" transaction to earn a fee and facilitate a short sale by Gamma Bank. See STA s. 104(2) and PPSA s. 28(10).

Perfection of security interest

Securities account

19.1 (1) Perfection of a security interest in a securities account also perfects a security interest in the security entitlements carried in the securities account.

Futures account

(2) Perfection of a security interest in a futures account also perfects a security interest in the futures contracts carried in the futures account.

Source: UCC Rev 9-308.

Comparison with previous law: Not applicable.

Explanation: Sections 19.1(1) and 19.1(2) correspond to the rules for attachment in sections 11(4) and 11(5).

Perfection of security interest on attachment

19.2 (1) A security interest arising in the delivery of a financial asset under subsection 11.1(2) is perfected when it attaches.

Same

(2) A security interest in investment property created by a broker or securities intermediary is perfected when it attaches.

Same

(3) A security interest in a futures contract or a futures account created by a futures intermediary is perfected when it attaches.

Source: UCC Rev 9-309.

Comparison with previous law: Not applicable.

Explanation: Section 19.2(1) addresses the automatic perfection of a security interest created by section 11.1(2) arising in certain circumstances where a certificated security or other financial asset represented by a writing is delivered for payment.

As to sections 19.2(2) and 19.2(3), the following description provides some background for understanding these rules. Secured financing arrangements for credit advanced to securities firms are currently implemented in various ways. In

some circumstances, lenders may require that the transactions be structured as "hard pledges", where the securities are transferred on the books of a clearing agency from the debtor's account to the lender's account or to a special pledge account for the lender where they cannot be disposed of without the specific consent of the lender. In other circumstances, lenders are content with so-called "agreement to pledge" or "agreement to deliver" arrangements, where the debtor retains the positions in its own account, but reflects on its books that the positions have been hypothecated and promises that the securities will be transferred to the secured party's account on demand.

The perfection and priority rules of the PPSA are designed to facilitate current secured financing arrangements for securities firms as well as to provide sufficient flexibility to accommodate new arrangements that develop in the future. Hard pledge arrangements are covered by the concept of control. See PPSA ss. 22.1(1) and 1(2) and STA ss. 23 to 26. Non-control secured financing arrangements for securities firms are covered by the automatic perfection rule of section 19.2(2). Accordingly, a creditor of a securities firm should realize that the firm's securities may be subject to security interests that are not discoverable from any public records.

In some circumstances, a clearing agency may be the debtor in a secured financing arrangement. For example, a clearing agency that settles delivery-versus-payment transactions among its participants on a net, same-day basis relies on timely payments from all participants with net obligations due to the system. If a participant that is a net debtor were to default on its payment obligation, the clearing agency would not receive some of the funds needed to settle with participants that are net creditors to the system. To complete end-of-day settlement after a payment default by a participant, a clearing agency that settles on a net, same-day basis may need to draw on credit lines and pledge securities of the defaulting participant or other securities pledged by participants in the clearing agency to secure such drawings. The clearing agency may be the top-tier securities intermediary for the securities pledged, so that it would not be practical for the lender to obtain control. Even where the clearing agency holds some types of securities through other intermediaries, however, the clearing agency is unlikely to be able to complete the arrangements necessary to convey "control" over the securities to be pledged in time to complete settlement in a timely manner. However, the term "securities intermediary" is defined in STA s. 1(1) to include clearing agencies. Thus, the perfection rule of section 19.2(2) applies to security interests in investment property granted by clearing agencies.

Perfection

By possession or repossession

22. (1) Possession or repossession of the collateral by the secured party, or on the secured party's behalf by a person other than the debtor or the debtor's agent, perfects a security interest in,

(a) chattel paper;

(b) goods;

(c) instruments;

(d) negotiable documents of title; and

(e) money,

but only while it is actually held as collateral.

By delivery

(2) A secured party may perfect a security interest in a certificated security by taking delivery of the certificated security under section 68 of the *Securities Transfer Act, 2006*.

Same

(3) A security interest in a certificated security in registered form is perfected by delivery when delivery of the certificated security occurs under section 68 of the *Securities Transfer Act, 2006* and remains perfected by delivery until the debtor obtains possession of the security certificate.

Source: UCC Rev 9-313.

Comparison with previous law: PPSA s. 22.

Explanation: Section 22(2) reflected the traditional rule for perfection of a security interest in certificated securities. It has been modified to refer to "delivery" under STA s. 68. Corresponding changes appear in PPSA s. 11(2)(c). For delivery to occur when a person other than a secured party holds possession for the secured party, the person may not be a securities intermediary, unless the security certificate is registered in the name of the secured party, payable to the order of the secured party, or specially endorsed to the secured party and not endorsed to the securities intermediary in blank. See STA ss. 68(1)(b) and 68(1)(c).
Under section 22(3), a security interest in a certificated security in registered form perfected by delivery remains perfected until the debtor obtains possession of the security certificate. This rule is analogous to that of PPSA s. 22.1(2), which deals with perfection of security interests in investment property by control. See PPSA s. 22.1(2), Comments.

Perfection by control of collateral

22.1 (1) A security interest in investment property may be perfected by control of the collateral under subsection 1(2).

Same

(2) A security interest in investment property is perfected by control under subsection 1(2) from the time the secured party obtains control and remains perfected by control until,

(a) the secured party does not have control; and

(b) one of the following occurs:

(i) if the collateral is a certificated security, the debtor has or acquires possession of the security certificate,

(ii) if the collateral is an uncertificated security, the issuer has registered or registers the debtor as the registered owner, or

(iii) if the collateral is a security entitlement, the debtor is or becomes the entitlement holder.

Source: UCC Rev 9-314.

Comparison with previous law: Not applicable.

Explanation: This section provides for perfection by control with respect to investment property. For explanations of how a secured party takes control of investment property, see PPSA s. 1(2).

Delivery of a certificated security in registered form a secured party does not itself give the secured party "control" of the security, which requires in addition an effective endorsement or registration on the books of the issuer. See STA s. 23(2). This distinction could in theory affect the priority position of a secured party whose security interest has been perfected by delivery but not by control: see s. 23 and related Comment.

Section 22.1(2) provides a special rule for investment property. Once a secured party has control, its security interest remains perfected by control until the secured party ceases to have control and the debtor receives possession of collateral that is a certificated security, becomes the registered owner of collateral that is an uncertificated security, or becomes the entitlement holder of collateral that is a security entitlement. The result is particularly important in the "repledge" or "reuse" context. See PPSA s. 17.1, Comments 2 and 4.

In a transaction in which a secured party who has control grants a security interest in investment property or sells outright the investment property, by virtue of the debtor's consent or applicable legal rules, a purchaser from the secured party

typically will cut off the debtor's rights in the investment property or be immune from the debtors claims. See PPSA s. 17.1, Comments 2 and 3. If the investment property is a security, the debtor normally would retain no interest in the security following the purchase from the secured party, and a claim of the debtor against the secured party for redemption (PPSA s. 66(1)) or otherwise with respect to the security would be a purely personal claim. If the investment property transferred by the secured party is a financial asset in which the debtor had a security entitlement credited to a securities account maintained with the secured party as a securities intermediary, the debtor's claim against the secured party could arise as a part of its securities account notwithstanding its personal nature. (This claim would be analogous to a "credit balance" in the securities account, which is a component of the securities account even though it is a personal claim against the intermediary.) In the case in which the debtor may retain an interest in investment property notwithstanding a repledge or sale by the secured party, section 22.1(2) makes clear that the security interest will remain perfected by control.

Perfection by registration

23. Registration perfects a security interest in any type of collateral.

Source: UCC Rev 9-312.

Comparison with previous law: PPSA s. 23.

Explanation: Registration perfects a security interest in any type of collateral. This means that a security interest in any investment property, including certificated securities, uncertificated securities, security entitlements, and securities accounts, may be perfected by registration. However, security interests created by brokers, securities intermediaries, or futures intermediaries are automatically perfected; registration is of no effect. See PPSA ss. 19.2(2) and 19.2(3). A security interest in all kinds of investment property also may be perfected by control, see PPSA ss. 22(1) and 1(2), and a security interest in a certificated security also may be perfected by the secured party's taking delivery under STA s. 68. See PPSA s. 22(2). A security interest perfected only by registration is subordinate to a conflicting security interest perfected by control or delivery. See PPSA ss. 30.1(2) and 30.1(3). Thus, although registration is a permissible method of perfection, a secured party who perfects by registration takes the risk that the debtor has granted or will grant a security interest in the same collateral to another party who obtains control. Also, perfection by registration would not give the secured party protection against other types of adverse claims, since the STA adverse claim cut-off rules require control. See STA s. 104.

Temporary perfection

24. (1) Repealed.

Idem

(2) A security interest perfected by possession in,

(a) an instrument or a certificated security that a secured party delivers to the debtor for,

(i) ultimate sale or exchange,

(ii) presentation, collection or renewal, or

(iii) registration of transfer; or

(b) a negotiable document of title or goods held by a bailee that are not covered by a negotiable document of title, which document of title or goods the secured party makes available to the debtor for the purpose of,

(i) ultimate sale or exchange,

(ii) loading, unloading, storing, shipping or trans-shipping, or

(iii) manufacturing, processing, packaging or otherwise dealing with goods in a manner preliminary to their sale or exchange,

remains perfected for the first ten days after the collateral comes under the control of the debtor.

Idem

(3) Beyond the period of ten days referred to in subsection (2), a security interest under this section becomes subject to the provisions of this Act for perfecting a security interest.

Source: UCC Rev 9-312.

Comparison with previous law: PPSA s. 24(2).

Explanation:

1. Repeal of section 24(1). Section 24(1) provided a rule for temporary perfection of a security interest in instruments, securities or negotiable documents of title for the first ten days after attachment to the extent it arises for new value secured by a written security agreement. This rule corresponds to UCC Rev. 9-312(a)(e). However, there was no corresponding provision in the other provincial PPSAs. The Working Group Report (at para. 109) recommended the repeal of section 24(1) because it was of little commercial significance. A secured party that wishes to perfect a security interest in investment property by control should therefore ensure that the requirements for control are met before or at the time credit is advanced.

2. Maintaining perfection after surrender of possession of a certificated security. There are several legitimate reasons -- many of them are described in s. 24(2)(a) -- that a certificated security must be released temporarily to a debtor. No useful purpose would be served by cluttering the PPSA registry system with registrations relating to such exceedingly short term transactions.

Section 24(2)(a) provides for 10-day perfection in instruments and certificated securities. UCC Rev 9-312(g) includes "enforcement" as one of the special and limited purposes for which a secured party can release an instrument or certificated security to the debtor and still remain perfected. "Enforcement" does not appear in PPSA s. 24(2)(a), but perhaps ought to be included.

The period of temporary perfection runs from the date a secured party who already has a perfected security interest turns over the collateral to the debtor. There is no new value requirement, but the turnover must be for one or more of the purposes stated in section 24(2)(a). The 10-day period may be extended by perfecting as to the collateral by another method before the period expires. However, if the security interest is not perfected by another method until after the 10-day period expires, there will be a gap during which the security interest is unperfected.

Temporary perfection extends only to the instrument or certificated security under section 24(2)(a). It does not extend to proceeds. If the collateral is sold, the security interest will continue in the proceeds for the period specified in PPSA s. 25.

Transactions in ordinary course of business

. . .

Securities

28(6) A purchaser of a security, other than a secured party, who,

(a) gives value;

(b) does not know that the transaction constitutes a breach of a security agreement granting a security interest in the security to a secured party that does not have control of the security; and

(c) obtains control of the security,

acquires the security free from the security interest.

Same

(7) A purchaser referred to in subsection (6) is not required to determine whether a security interest has been granted in the security or whether the transaction constitutes a breach of a security agreement.

No action against purchaser for value without notice of breach

(8) An action based on a security agreement creating a security interest in a financial asset, however framed, may not be brought against a person who acquires a security entitlement under section 95 of the *Securities Transfer Act, 2006* for value and did not know that there has been a breach of the security agreement.

Same

(9) A person who acquires a security entitlement under section 95 of the *Securities Transfer Act, 2006* is not required to determine whether a security interest has been granted in a financial asset or whether there has been a breach of the security agreement.

Same

(10) If an action based on a security agreement creating a security interest in a financial asset could not be brought against an entitlement holder under subsection (8), it may not be brought against a person who purchases a security entitlement, or an interest in it, from the entitlement holder.

Source: PPSA s. 28(7).

Comparison with previous law: PPSA s. 28(7).

Explanation:

Prior to January 1, 2007, section 28(7) of the PPSA provided a cut-off rule for the protection of securities dealers and others who purchased a security in the ordinary course of business and took possession of it, affording those purchasers priority over any security interest perfected by registration or temporarily perfected under the PPSA, even though the purchaser knows of the security interest, as long as the purchaser did not know the purchase constituted a breach of the security agreement. This special cut-off rule was designed to facilitate the marketability of securities. There was no counterpart in UCC Rev 8 or UCC Rev 9 because, until recently, a security interest in a certificated security could be obtained only through possession of the security certificate, and registration did not perfect a security interest in securities.

Sections 28(6) and (7) retain this cut-off rule in a slightly different form. The new cut-off rule is available only to a buyer of a security (and not available to a secured party) who obtains control and does not know that the acquisition by it of the security breaches a security agreement. It is implicit in this rule that a buyer may know of a security interest, but takes free of that security interest as long as the buyer not know that the transfer breaches a security agreement. The old requirement for a

purchase in the ordinary course of business is eliminated.

Section 28(7) clarifies that a buyer relying on the cut-off rule in section 28(6) is not required to determine whether a security interest has been granted, nor whether the transaction breaches a security agreement.

To state the obvious, sections 28(6) and 28(7) allow the buyer to acquire the security ***free*** from the prior security interest. These rules are not merely rules of priority. They offer the buyer more protection than is available to a secured party which obtains control and is relying on PPSA s. 30.1(2).

In addition, sections 28(6) to 28(7) provide some additional protection for a buyer as compared with the protected purchaser rule in STA s. 70. PPSA s. 28(6)(b) requires that the buyer does not ***know*** (see PPSA s. 69) the transaction constitutes a breach of a security agreement; and section 28(7) disclaims any obligation for the buyer to make enquiries. In contrast, the definition of protected purchaser would require that a buyer not have notice of any adverse claim -- a standard defined by the STA to preclude a buyer's willful blindness. (see STA s. 18(b)) It is probably easier for a buyer to satisfy the test under sections 28(6) and (7) of the PPSA, than the test in the definition of protected purchaser. The Working Group Report indicates (at paras. 113 to 114) that some members of the group considered that it would be useful to, in effect, clarify that a buyer of securities was never obligated to carry out due diligence, even where the buyer knew a financing statement registered under the PPSA against the seller was broad enough to perfect a security interest in securities, as long as the buyer did not know that the transfer to it would breach a security agreement.

Whatever view one takes about the relative protection offered to a buyer under sections 28(6) and 28(7) of the PPSA as compared with the protected purchaser rule in STA s. 70, the PPSA cannot derogate from the buyer's rights under STA s. 70 or otherwise. See PPSA ss. 28.1(1) to 28.1(3).

Sections 28(8) to 28(10) provide protection in the indirect holding system for a person acquiring a security entitlement. Those rules are analogous to the rule in section 28(6) applicable to a buyer of a certificated or uncertificated security. The Working Group Report indicates (at para. 115) that opinion of the group members diverged as to the need for section 28(10). Several members took the position that, under well-established PPSA principles, a cut-off rule protects not only immediate buyers but also subsequent buyers or purchasers.

Rights of protected purchaser

28.1 (1) This Act does not limit the rights that a protected purchaser of a security has under the *Securities Transfer Act, 2006*.

Same

(2) The interest of a protected purchaser of a security under the *Securities Transfer Act, 2006* takes priority over an earlier security interest, even if perfected, to the extent provided in that Act.

Same

(3) This Act does not limit the rights of or impose liability on a person to the extent that the person is protected against the assertion of a claim under the *Securities Transfer Act, 2006*.

Source: UCC Rev 9-331.

Comparison with previous law: Not applicable.

Explanation:

1. "Priority". Whether a protected purchaser referred to in this section takes free of or is senior to a security interest depends on whether the purchaser is a buyer of the collateral or takes a security interest in it. The term "priority" is meant to encompass both scenarios.

2. Rights Acquired by Purchasers. The rights to which this section refers are set forth in STA s. 70. The use of the phrase "to the extent provided in that Act" in section 28.1(2) is odd, and does not seem appropriate in this context. *Cf.* UCC Rev. 9-331, Comment 3.

3. Financial Assets and Security Entitlements. Section 28.1(3) provides explicit protection for those who deal with financial assets and security entitlements and who are immunized from liability under the STA. See, *e.g.*, STA ss. 96, 97(7), 104 and 105.

4. Overlap With Sections 28(6) to 28(10). Section 28.1 overlaps with sections 28(6) to 28(10). The Working Group Report indicates (at para. 116) that it was not able to reach a final conclusion as to the need for section 28.1; but it was included on the basis that users of the PPSA may otherwise have difficulty appreciating the interface between the PPSA cut-off rules and the STA protected purchaser rules.

5. Priority Between Two Secured Creditors With Control of an Uncertificated Security Under STA s. 24(1)(b). Where two secured creditors have each obtained control of an uncertificated security under STA s. 24(1)(b) and have not agreed as to their priority between themselves, it is not intended that the secured party which is second to obtain control can subvert the normal priority rule in PPSA s. 30.1(4)(b)(ii) by attempting to rely on the protected purchaser rule in STA s. 70. The priority

between those secured creditors should be addressed by s. 30.1(4), regardless of the knowledge of the secured creditors or the possibility that one of them might qualify as a protected purchaser under STA s. 70.

Priority rules for security interests in investment property

30.1 (1) The rules in this section govern priority among conflicting security interests in the same investment property.

Secured party with control

(2) A security interest of a secured party having control of investment property under subsection 1 (2) has priority over a security interest of a secured party that does not have control of the investment property.

Certificated security perfected by delivery

(3) A security interest in a certificated security in registered form which is perfected by taking delivery under subsection 22 (2) and not by control under section 22.1 has priority over a conflicting security interest perfected by a method other than control.

Rank by priority in time

(4) Except as otherwise provided in subsections (5) and (6), conflicting security interests of secured parties each of which has control under subsection 1 (2) rank according to priority in time of,

(a) if the collateral is a security, obtaining control;

(b) if the collateral is a security entitlement carried in a securities account,

(i) the secured party's becoming the person for which the securities account is maintained, if the secured party obtained control under clause 25 (1) (a) of the *Securities Transfer Act, 2006*,

(ii) the securities intermediary's agreement to comply with the secured party's entitlement orders with respect to security entitlements carried or to be carried in the securities account, if the secured party obtained control under clause 25 (1) (b) of the *Securities Transfer Act, 2006*, or

(iii) if the secured party obtained control through another person under clause 25 (1) (c) of the *Securities Transfer Act, 2006*, when the other person obtained control; or

(c) if the collateral is a futures contract carried with a futures intermediary, the satisfaction of the requirement for control specified in subclause 1 (2) (d) (ii) with respect to futures contracts carried or to be carried with the futures intermediary.

Securities intermediary

(5) A security interest held by a securities intermediary in a security entitlement or a securities account maintained with the securities intermediary has priority over a conflicting security interest held by another secured party.

Futures intermediary

(6) A security interest held by a futures intermediary in a futures contract or a futures account maintained with the futures intermediary has priority over a conflicting security interest held by another secured party.

Interests granted by broker, intermediary

(7) Conflicting security interests granted by a broker, securities intermediary or futures intermediary which are perfected without control under subsection 1 (2) rank equally.

Priority determined under s. 30

(8) In all other cases, priority among conflicting security interests in investment property shall be governed by section 30.

Source: UCC Rev 9-328.

Comparison with previous law: Not applicable.

Explanation:

1. Scope of This Section. This section contains the rules governing the priority of conflicting security interests in investment property. Section 30.1(2) states the most important general rule --that a secured party who obtains control has priority over a secured party who does not obtain control. Section 30.1(3) addresses the priority of a security interest in a certificated security which is perfected by delivery but not control. Except as provided in sections 30.1(5) and 30.1(6), the rules in section 30.1(4) deal with conflicting security interests, each of which is perfected by control. Sections 30.1(5) and (6) deal with conflicts between security interests in a security entitlement, securities account, futures contract or futures account held by a securities intermediary or futures intermediary with security interests in the same collateral held by other secured parties, in each case granting priority to the securities intermediary or futures intermediary, as the case may be. Section 30.1(7) deals with the relatively unusual circumstance in which a broker, securities intermediary, or futures intermediary has created conflicting security interests none of which is perfected by control. Section 30.1(8) provides that the general priority rules of section 30 apply to cases not covered by the specific rules in this section. The principal application of this residual rule is that the usual first in time of registration rule applies to conflicting security interests that are perfected only by registration. "Investment property" is excluded from the definition of "purchase-

money security interest" because the control priority rules of each of sections 30.1(2) and 30.1(5) provide for the ordinary cases in which persons purchase securities on margin credit from their brokers. As a consequence, there is no need for special priority rules for purchase-money security interests in investment property.

2. General Rule: Priority of Security Interest Perfected by Control. Under section 30.1(2), a secured party who obtains control has priority over a secured party who does not obtain control. The control priority rule does not turn on either temporal sequence or awareness of conflicting security interests. Rather, it is a structural rule, based on the principle that a lender should be able to rely on the collateral without question if the lender has taken the necessary steps to assure itself that it is in a position where it can dispose of the collateral without further action by the debtor. The control priority rule is necessary because the perfection rules provide considerable flexibility in structuring secured financing arrangements. For example, at the "retail" level, a secured lender to an investor who wants the full measure of protection can obtain control, but the creditor may be willing to accept the greater measure of risk that follows from perfection by registration. Similarly, at the "wholesale" level, a lender to securities firms can leave the collateral with the debtor and obtain a perfected security interest under the automatic perfection rule of section 19.2(2), but a lender who wants to be entirely sure of its position will want to obtain control. The control priority rule of section 30.1(2) is an essential part of this system of flexibility. It is feasible to provide more than one method of perfecting security interests only if the rules ensure that those who take the necessary steps to obtain the full measure of protection do not run the risk of subordination to those who have not taken such steps. A secured party who is unwilling to run the risk that the debtor has granted or will grant a conflicting control security interest should not make a loan without obtaining control of the collateral.

As applied to the retail level, the control priority rule means that a secured party who obtains control has priority over a conflicting security interest perfected by registration without regard to inquiry into whether the control secured party was aware of the registered security interest. Because of the large volume of transactions, and recognizing the effect of rules such as section 28(7) of the PPSA as it existed prior to January 1, 2007, parties who deal in securities typically have not carried out searches under the PPSA before conducting securities transactions. In order to avoid disruption of existing practices in this business, it is necessary to give perfection by registration a different and more limited effect for securities than for some other forms of collateral. The priority rules are not based on the assumption that parties who perfect by the usual method of obtaining control will search the PPSA registry. Quite the contrary, the control priority rule is intended to ensure that, with respect to investment property, secured parties who do obtain control are entirely unaffected by registrations. To state the point another way, perfection by

registration is intended to affect only general creditors or other secured creditors who rely on registration. The rule that a security interest perfected by registration can be primed by a control security interest, without regard to awareness, is a consequence of the system of perfection and priority rules for investment property. These rules are designed to take account of the circumstances of the securities markets, where registration is not given the same effect as for some other forms of property. No implication is made about the effect of registration with respect to security interests in other forms of property, nor about other PPSA rules, *e.g.*, sections 28(3) or 28(4), which govern the circumstances in which security interests in other forms of property perfected by registration can be primed by subsequent perfected security interests.

The following examples illustrate the application of the priority rule in section 30.1(2):

Example 1: Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. for which Debtor has a certificate. Alpha perfects by registration. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. Debtor delivers the certificate, properly endorsed, to Beta. Alpha and Beta both have perfected security interests in the XYZ Co. Beta has control (see STA s. 23(2)(a)), and hence has priority over Alpha.

Example 2: Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co., held through a securities account with Able & Co. Alpha perfects by registration. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. Debtor instructs Able to have the 1000 shares transferred through the clearing agency to Custodian Bank, to be credited to Beta's account with Custodian Bank. Alpha and Beta both have perfected security interests in the XYZ Co. Beta has control (see STA s. 25(1)(a)), and hence has priority over Alpha.

Example 3: Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co., which is held through a securities account with Able & Co. Alpha perfects by registration. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Alpha and Beta both have perfected security interests in the XYZ Co. (more precisely, in the Debtor's security entitlement to the financial asset consisting of the XYZ Co. shares). Beta has control, see STA s. 25(1)(b), and hence has priority over Alpha.

Example 4: Debtor borrows from Alpha and grants Alpha a security interest in a

variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co., held through a securities account with Able & Co. Alpha perfects by registration. Debtor's agreement with Able & Co. provides that Able has a security interest in all securities carried in the account as security for any obligations of Debtor to Able. Debtor incurs obligations to Able and later defaults on the obligations to Alpha and Able. Able has control by virtue of the rule of STA s. 26 that if a customer grants a security interest to its own intermediary, the intermediary has control. Since Alpha does not have control, Able has priority over Alpha under the general control priority rule of section 30.1(2).

3. Conflicting Security Interests Perfected by Control: Priority of Securities Intermediary or Futures Intermediary. Sections 30.1(4) through 30.1(6) govern the priority of conflicting security interests each of which is perfected by control. The following example explains the application of the rules in sections 30.1(5) and 30.1(6):

Example 5: Debtor holds securities through a securities account with Able & Co. Debtor's agreement with Able & Co. provides that Able has a security interest in all securities carried in the account as security for any obligations of Debtor to Able. Debtor borrows from Beta and grants Beta a security interest in 1000 shares of XYZ Co. carried in the account. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Debtor incurs obligations to Able and later defaults on the obligations to Beta and Able. Both Beta and Able have control, so the general control priority rule of section 30.1(2) does not apply. Compare Example 4. Section 30.1(5) provides that a security interest held by a securities intermediary in positions of its own customer has priority over a conflicting security interest of an external lender, so Able has priority over Beta. (Section 30.1(6) contains a parallel rule for futures intermediaries.) The agreement among Able, Beta, and Debtor could, of course, determine the relative priority of the security interests of Able and Beta (see PPSA s. 38), but the fact that the intermediary has agreed to act on the instructions of a secured party such as Beta does not itself imply any agreement by the intermediary to subordinate.

4. Conflicting Security Interests Perfected by Control: Temporal Priority. Section 30.1(4) governs priority in those circumstances in which more than one secured party (other than a broker, securities intermediary, or futures intermediary) has control. For securities, both certificated and uncertificated, under section 30.1(4)(a) priority is based on the time that control is obtained. For security entitlements carried in securities accounts, the treatment is more complex. Section 30.1(4)(b) bases priority on the timing of the steps taken to achieve control. The following example illustrates the application of Section 30.1(4).

Example 6: Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns a security entitlement that includes 1000 shares of XYZ Co. that Debtor holds through a securities account with Able & Co. Debtor, Able, and Alpha enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Alpha will also have the right to direct dispositions and receive the proceeds. Later, Debtor borrows from Beta and grants Beta a security interest in all its investment property, existing and after-acquired. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Alpha and Beta both have perfected-by-control security interests in the security entitlement to the XYZ Co. shares by virtue of their agreements with Able. See PPSA ss. 22.1(1) and 1(2)(c) and STA s. 25(1)(b). Under section 30.1(4)(b)(ii), the priority of each security interest dates from the time of the secured party's agreement with Able. Because Alpha's agreement was first in time, Alpha has priority. This priority applies equally to security entitlements to financial assets credited to the account after the agreement was entered into.

The priority rule is analogous to "first-to-register" priority under section 30(1). Sections 30.1(4)(b)(i) and 30.1(4)(b)(iii) provide similar rules for security entitlements as to which control is obtained by other methods, and section 30.1(4)(c) provides a similar rule for futures contracts carried in a futures account. STA s. 104(3) has a temporal priority conforming to section 30.1(4)(b).

5. Certificated Securities. A long-standing practice has developed whereby secured parties whose collateral consists of a security evidenced by a security certificate take possession of the security certificate. If the security certificate is in bearer form, the secured party's acquisition of possession constitutes "delivery" under STA s. 68(1)(a), and the delivery constitutes "control" STA s. 23(1). Comment 4 discusses the priority of security interests perfected by control of investment property.

If the security certificate is in registered form, the secured party will not achieve control over the security unless the security certificate bears an appropriate endorsement or is (re)registered in the secured party's name. See STA s. 23(2). However, the secured party's acquisition of possession constitutes "delivery" of the security certificate under STA s. 68(1)(a) and serves to perfect the security interest under PPSA s. 22(2), even if the security certificate has not been appropriately endorsed and has not been (re)registered in the secured party's name. A security interest perfected by this method has priority over a security interest perfected other than by control (*e.g.*, by registration). See section 30.1(3).

The priority rule stated in section 30.1(3) may seem anomalous, in that it can afford

less favorable treatment to purchasers who buy collateral outright than to those who take a security interest in it. For example, a buyer of a security certificate would cut off a security interest perfected by registration only if the buyer achieves the status of a protected purchaser under STA s. 70. The buyer would not be a protected purchaser, for example, if it does not obtain "control" under STA s. 23(2) (*e.g.*, if it fails to obtain a proper endorsement of the certificate) or if it had notice of an adverse claim under STA s. 18. The apparent anomaly disappears, however, when one understands the priority rule not as one intended to protect careless or guilty parties, but as one that eliminates the need to conduct a search of the public records only insofar as necessary to serve the needs of the securities markets.

6. Secured Financing of Securities Firms. Priority questions concerning security interests granted by brokers and securities intermediaries are governed by the general control-beats-non-control priority rule of section 30.1(2), as supplemented by the special rules set out in sections 30.1(4)(temporal priority -- first to control), 30.1(5) (special priority for securities intermediary), and 30.1(7) (equal priority for non-control). The following examples illustrate the priority rules as applied to this setting. (In all cases it is assumed that the debtor retains sufficient other securities to satisfy all customers' claims. This section deals with the relative rights of secured lenders to a securities firm. Disputes between a secured lender and the firm's own customers are governed by STA s. 105.)

Example 7: Able & Co., a securities dealer, enters into financing arrangements with two lenders, Alpha Bank and Beta Bank. In each case the agreements provide that the lender will have a security interest in the securities identified on lists provided to the lender on a daily basis, that the debtor will deliver the securities to the lender on demand, and that the debtor will not list as collateral any securities which the debtor has pledged to any other lender. Upon Able's insolvency it is discovered that Able has listed the same securities on the collateral lists provided to both Alpha and Beta. Alpha and Beta both have perfected security interests under the automatic-perfection rule of PPSA s. 19.2(2). Neither Alpha nor Beta has control. Section 30.1(7) provides that the security interests of Alpha and Beta rank equally, because each of them has a non-control security interest granted by a securities firm. They share pro-rata.

Example 8: Able enters into financing arrangements, with Alpha Bank and Beta Bank as in Example 7. At some point, however, Beta decides that it is unwilling to continue to provide financing on a non-control basis. Able directs the clearing agency where it holds its principal inventory of securities to move specified securities into Beta's account. Upon Able's insolvency it is discovered that a list of collateral provided to Alpha includes securities that had been moved to Beta's account. Both Alpha and Beta have perfected security interests; Alpha under the automatic-perfection rule of PPSA s. 19.2(2), and Beta under that rule and also the perfection-

by-control rule in PPSA s. 22.1(1). Beta has control but Alpha does not. Beta has priority over Alpha under section 30.1(2).

Example 9: Able & Co. carries its principal inventory of securities through Clearing Corporation, which offers a "shared control" facility whereby a participant securities firm can enter into an arrangement with a lender under which the securities firm will retain the power to trade and otherwise direct dispositions of securities carried in its account, but Clearing Corporation agrees that, at any time the lender so directs, Clearing Corporation will transfer any securities from the firm's account to the lender's account or otherwise dispose of them as directed by the lender. Able enters into financing arrangements with two lenders, Alpha and Beta, each of which obtains such a control agreement from Clearing Corporation. The agreement with each lender provides that Able will designate specific securities as collateral on lists provided to the lender on a daily or other periodic basis, and that it will not pledge the same securities to different lenders. Upon Able's insolvency, it is discovered that Able has listed the same securities on the collateral lists provided to both Alpha and Beta. Both Alpha and Beta have control over the disputed securities. Section 30.1(4)(b)(ii) awards priority to whichever secured party first entered into the agreement with Clearing Corporation.

7. Relation to Other Law. PPSA s. 72 provides that "[e]xcept in so far as they are inconsistent with the express provisions of this Act, the principles of law and equity, including the law merchant, the law relating to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake and other validating or invalidating rules of law, shall supplement this Act and shall continue to apply." There may be circumstances in which a secured party's action in acquiring a security interest that has priority under this section constitutes conduct that is wrongful under other law. Though the possibility of such resort to other law may provide an appropriate "escape valve" for cases of egregious conduct, care must be taken to ensure that this does not impair the certainty and predictability of the priority rules. Whether a court may appropriately look to other law to impose liability upon or estop a secured party from asserting its PPSA priority depends on an assessment of the secured party's conduct under the standards established by such other law as well as a determination of whether the particular application of such other law is displaced by the PPSA.

Some circumstances in which other law is clearly displaced by the PPSA rules are readily identifiable. Common law "first in time, first in right" principles, or correlative tort liability rules such as common law conversion principles under which a purchaser may incur liability to a person with a prior property interest without regard to awareness of that claim, are necessarily displaced by the priority rules set out in this section since these rules determine the relative ranking of security interests in investment property. So too, the STA provides protections against adverse claims to

certain purchasers of interests in investment property. In circumstances where a secured party not only has priority under section 30.1, but also qualifies for protection against adverse claims under STA ss. 70, 96 or 104, resort to other law would be precluded.

In determining whether it is appropriate in a particular case to look to other law, account must also be taken of the policies that underlie the commercial law rules on securities markets and security interests in securities. A principal objective of the STA and the provisions of the PPSA governing investment property is to ensure that secured financing transactions can be implemented on a simple, timely and certain basis. One of the circumstances that led to the enactment of the STA and related PPSA amendments was the concern that uncertainty in the application of the rules on secured transactions involving securities and other financial assets could contribute to systemic risk by impairing the ability of financial institutions to provide liquidity to the markets in times of stress. The control priority rule is designed to provide a clear and certain rule to ensure that lenders who have taken the necessary steps to establish control do not face a risk of subordination to other lenders who have not done so.

The control priority rule does not turn on an enquiry into the state of a secured party's awareness of potential conflicting claims because a rule under which a person's rights depended on that sort of after-the-fact inquiry could introduce an unacceptable measure of uncertainty. If an inquiry into awareness could provide a complete and satisfactory resolution of the problem in all cases, the priority rules of this section would have incorporated that test. The fact that they do not necessarily means that resort to other law based solely on that factor is precluded, though the question whether a control secured party induced or encouraged its financing arrangement with actual knowledge that the debtor would be violating the rights of another secured party may, in some circumstances, appropriately be treated as a factor in determining whether the control party's action is the kind of egregious conduct for which resort to other law is appropriate.

Discharge or amendment

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No outstanding secured obligation

56(7) Where there is no outstanding secured obligation, and the secured party is not committed to make advances, incur obligations or otherwise give value, a secured party having control of investment property under clause 25(1)(b) of the *Securities Transfer Act, 2006* or subclause 1(2)(d)(ii) of this Act shall, within 10 days after receipt of a written demand by the debtor, send to the securities intermediary or futures intermediary with which the security entitlement or futures contract is maintained a written record that releases the securities intermediary or futures

intermediary from any further obligation to comply with entitlement orders or directions originated by the secured party.

Source: UCC Rev 9-208(b)(4)

Comparison with previous law: Not applicable.

Explanation:

1. Scope and Purpose. Section 56(7) imposes duties on a secured party who has control of investment property. The duty to terminate the secured party's control is analogous to the duty to deliver a financing change statement, imposed by section 56(1). The duty applies only when there is no outstanding secured obligation and the secured party is not committed to make advances, incur obligations or otherwise give value. The requirements of this section can be varied by agreement. For example, a debtor could by contract agree that the secured party may comply with section 56(7) by releasing control more than 10 days after demand.

2. Remedy for Failure to Relinquish Control. Section 56(4) provides a remedy if a secured party fails to deliver the financing change statement or certificate of discharge or partial discharge required under sections 56(1) through 56(2.2). The PPSA does not provide any remedy if a secured party fails to comply with section 56(7). This oversight ought not to preclude a debtor from recovering any damages resulting from that failure.

3. Duty to Relinquish Possession. The PPSA does not require the secured party to relinquish possession of collateral when the secured party ceases to hold a security interest. Under common law, absent agreement to the contrary, the failure to relinquish possession of collateral upon satisfaction of the secured obligation would constitute a conversion. Inasmuch as problems apparently have not surfaced in the absence of statutory duties under the PPSA and the common law duty appears to have been sufficient, the PPSA does not impose a statutory duty to relinquish possession.

Transition re *Securities Transfer Act, 2006*

84. (1) The provisions of the *Securities Transfer Act, 2006*, including the provisions in Part VIII of that Act, do not affect an action or other proceeding commenced before this section comes into force.

Same

(2) No further action is required to continue perfection of a security interest in a security if,

(a) the security interest in the security was a perfected security interest immediately before this section comes into force; and

(b) the action by which the security interest was perfected would suffice to perfect the security interest under this Act.

Same

(3) A security interest in a security remains perfected for a period of four months after this section comes into force and continues to be perfected thereafter where appropriate action to perfect the security interest under this Act is taken within that period if,

(a) the security interest in the security was a perfected security interest immediately before this section comes into force; but

(b) the action by which the security interest was perfected would not suffice to perfect the security interest under this Act.

Same

(4) A financing statement or financing change may be registered under this Act within the four-month period referred to in subsection (3) to continue that perfection, or thereafter to perfect, if,

(a) the security interest was a perfected security interest immediately before this section comes into force; and

(b) the security interest can be perfected by registration under this Act.

Source: UCC Rev 8-602

Comparison with previous law: Not applicable

Explanation:

1. Scope. This section contains transitional rules that set out the limited circumstances in which the new rules governing investment property imposed by the STA and amendments to the PPSA do not apply after January 1, 2007. The transitional rule in section 84(1) parallels the similar rule in STA s. 9. The rule in section 84(2) makes it unnecessary to re-perfect a security interest in investment property where immediately prior to January 1, 2007, the security interest was a perfected security interest and the steps taken to perfect that security interest would be sufficient to do so under the new regime. If the second requirement does not apply, then section 84(3) requires that the security interest in question be re-perfected within four months after January 1, 2007 -- before May 1, 2007 -- in order for the secured party to maintain its original perfection. If this requirement is not met, the security interest would become unperfected on May 1, 2007. Section 84(4) would apply in situations where a security interest in investment property was perfected other than by registration prior to January 1, 2007; and if this section is

complied with, perfection is continued by registration notwithstanding the expiry of the four month transition period.

2. Background and Purpose. In general, the new rules relating to the validity, perfection and priority of security interests in investment property will apply to "transactions," "events," "rights," "duties," "liabilities," or the like that occurred or accrued both before and after January 1, 2007. One reason for enacting the STA and corresponding amendments to the PPSA was a concern that the provisions of the prior law could be interpreted or misinterpreted to yield results that impede the safe and efficient operation of the system for the clearance and settlement of securities transactions. Accordingly, the new legislation does not generally preserve the applicability of the prior law to transactions and events that occurred before January 1, 2007.

Only two circumstances seem to warrant continued application of rules of the prior law. First, to avoid disruption in the conduct of litigation, it makes sense to provide for continued application of the prior law rules to proceedings commenced before January 1, 2007. This continuity is preserved in Section 84(1). Second, there may be some limited circumstances in which prior law permitted perfection of security interests by methods that would not suffice to perfect a security interest under the PPSA as amended. In those circumstances it seems appropriate to include a provision that gives a secured creditor some opportunity after the effective date to perfect in this or any other case in which there is doubt whether the method of perfection used under prior law would be sufficient under the amended PPSA. This opportunity is provided in sections 84(3) and (4).

The need for the second set of transitional rules is somewhat less acute under the PPSA than it was under UCC Rev 8. It would appear that the corresponding rule in UCC Rev 8 was required principally because under prior versions of Article 8 a security interest in investment property could not be perfected by filing, but perfection could be obtained through certain alternative means that would not constitute control under UCC Rev 8. For example, UCC s. 8-313(1)(h) (1978 version) permitted perfection of security interests in securities held through intermediaries by simple notice to the intermediary. Under UCC Rev 8 and 9, mere notice to the securities intermediary would not suffice to perfect such a security interest by control, which would require the agreement of the intermediary to take entitlement orders from the secured party. If the secured party had not obtained such an agreement, the action that sufficed to perfect the security interest under the prior law would no longer suffice under the new law. In contrast, since 1989, it has been possible to perfect a security interest in securities through registration as well as physical or deemed possession, and the other actions that would have perfected

a security interest under the old rules would in general still suffice to do so under the new.

3. Application of the Transitional Rules. There will be few fact situations that would engage Section 84(3) and require re-perfection prior to May 1, 2007. One such situation would involve perfection of a security interest in property that prior to January 1, 2007 was considered a "security" but on and after that date would not be so defined. For example, the former definition of "security" under the PPSA could have been interpreted to encompass privately traded units in a limited partnership. If such units had been evidenced by a certificate, physical possession of the certificate would have sufficed to perfect a security interest in the units under PPSA s. 22(2) prior to January 1, 2007. However, on or after that date, the units would cease to be "securities" for the purposes of the STA unless they were publicly traded, the terms of the units expressly provided that they are securities for the purposes of the STA or they are units in an open-end mutual fund: see STA s. 12(1). If the units are not securities, then physical possession of a unit certificate (which would constitute either delivery or control if it represented a security) would no longer suffice to perfect a security interest in the unit. If such security interest had not also been perfected by registration, it would therefore be necessary to register a financing statement before May 1, 2007, in order to continue perfection of the security interest under PPSA s. 84(4). The priority of competing security interests in the unit would be determined by the general priority rules in PPSA section 30.

4. Constructive Possession and Control. One issue raised by PPSA ss. 84(2) and (3) is whether perfection of a security interest in indirectly held securities through constructive possession pursuant to section 85 of the *Business Corporations Act* was a method that would "suffice to perfect" the security interest under the amended PPSA and so not require re-perfection prior to May 1, 2007. The answer is yes, it suffices to perfect. For example, if on November 1, 2006, Alpha pledged 1000 shares of ABC Ltd. to Bank, and Alpha instructed its Broker A to transfer the position to Bank's Broker B and that transfer was recorded by CDS Clearing and Depository Services Inc., the Bank would have constructive possession of the 1000 shares by virtue of section 85, and its security interest would have been perfected by possession. If the Bank did nothing more before May 1, 2007, some might argue that the Bank ceased to be perfected because section 85 has been repealed and the concept of constructive possession no longer exists. This argument should fail because "the action by which the security interest was perfected" under section 85 was "the making of an appropriate entry in the record of the clearing agency" in respect of the financial asset, which resulted in the asset being credited to the securities account of Broker B with CDS Clearing and

Depository Services Inc. Under the STA, the Bank is the entitlement holder in respect of the 1000 shares held on its behalf by Broker B, has control of that security entitlement and is perfected. See STA ss. 25(1)(a) and 95(1)(a) and PPSA s. 1(2)(c). Therefore, PPSA s. 84(3) will not be engaged because Bank is perfected by control. Even if this were not the case, after January 1, 2007, Bank could still defeat any security interest in the 1000 shares perfected otherwise than by control by virtue of the fact that it is "a secured party *having* control" of the security entitlements to those shares even though it may not have perfected its security interest through control: see PPSA s. 30.1(2).